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Supreme Court of the United States

October Term, 1962

No. 70

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,

Petitioners,

against

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC., *et al.*,

Respondents.

In the Matter
of
NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC.,

Debtor.

BRIEF FOR PETITIONERS

On Writs of Certiorari to the United States Court of Appeals for the Second Circuit

In Proceedings for the Reorganization of a Corporation
TWO CASES (No. 26362 and No. 27000)

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Supreme Court of the United States

October Term, 1962

No. 70

IRVING J. WOLF, ROBERT H. DAVIDSON, RICHARD S. HULL and FREDERICK KATZENELL,

Petitioners,

against

ARNOLD A. WEINSTEIN, JEROME FRIED, NAZARETH FAIR GROUNDS & FARMERS' MARKET, *et al.*,

Respondents.

In the Matter
of
NAZARETH FAIR GROUNDS & FARMERS' MARKET, INC.,

Debtor.

BRIEF FOR PETITIONERS

On Writs of Certiorari to the United States Court of Appeals for the Second Circuit

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In Proceedings for the Reorganization of a Corporation
TWO CASES (No. 26362 and No. 27000)

Opinions Below

In No. 26362, the District Court for the Southern District of New York (*per* SUGARMAN, *D. J.*) rendered a memorandum opinion on January 4, 1960 (R. 43) and an opinion from the bench on June 14, 1960 (R. 479-504), and made

findings of fact and conclusions of law, dated November 7, 1960, and filed November 23, 1960 (R. 243-257); they are not reported. In No. 27000, said District Court made findings of fact and conclusions of law, dated and filed October 19, 1960 (R. 229-243); they are not reported, and there is no opinion. The opinions of the Court of Appeals for the Second Circuit (*before* MOORE, FRIENDLY, and SMITH, *Cir. JJ.*) in No. 26362 (*per* FRIENDLY, *Cir. J.*) (R. 572-584) and in No. 27000 (*per* MOORE, *Cir. J.*) (R. 586-600) are reported at 296 F. 2d 678 and 296 F. 2d 670 (respectively).[1]

Jurisdiction

The judgments of the Court of Appeals for the Second Circuit were made and entered on November 9, 1961 (No. 26362: R. 584-5; No. 27000: R. 600-1). Petitions for rehearing of both cases were filed by Petitioners Wolf *et al.* on November 21, 1961 (No. 26362: R. 585; No. 27000: R. 601), and were denied without further opinion on November 29, 1961 (No. 26362: R. 585-6; No. 27000: R. 601-2). The petition for writs of certiorari in both cases was filed on February 21, 1962, as No. 739, October Term, 1961, and was granted on April 2, 1962 (R. 602, reported at 369 U. S. 837). The jurisdiction of this Court rests on 28 U. S. C. § 1254(1).[2]

---

[1] Petitioners have *not* sought review of a third companion case, No. 26962 (*see* R. 586-600). In addition, there have been five other appeals docketed in the Second Circuit Court of Appeals in these proceedings, *viz.*: No. 24564, reported at 249 F. 2d 221 (1957, *per* LUMBARD, *J.*); No. 25594, unreported (Debtor's appeal dismissed by Clerk for lack of prosecution, 1959); No. 26231, reported at 280 F. 2d 891 (1960, *p.c.*); No. 27248 and No. 27464, reported at 303 F. 2d 152 (1962, *per* SMITH, *J.*). (*See* 303 F. 2d *at* 153-4.)

[2] Arnold A. Weinstein, Jerome Fried, and Nazareth Fair Grounds & Farmers' Market, Inc. (the Debtor in possession, a nominal party) are Respondents in both No. 26362 and No. 27000. An additional Respondent in No. 26362 is Nazareth Enterprises, Inc. Additional Respondents in No. 27000 are all the beneficial owners of stock-claims besides the named Petitioners and Respondents.

Statutes Cited

The pertinent text of the constitutional provisions, statutes, and regulations which the case involves, is set forth in Appendix B, *infra*.

Questions Presented [3]

No. 27000

1. In a Chapter X reorganization proceeding, in adjudicating *claims* to stock interests in the debtor, which interests vested under state law prior to commencement of the reorganization proceedings and where no supervening federal statute or policy exists: Is the federal court (having *non-diversity* jurisdiction) required to apply *state rules of decision in equity?* If so, does the application of such state rules of decision extend to *remedies* as well as rights?

No. 26362

2. A Chapter X court has been petitioned to *remove* fiduciaries from office on the grounds of their personal trading in the debtor's stock *during* the reorganization proceedings and their diversions of the debtor's rents to themselves *during* the proceedings, and (on the same grounds) to deny them *compensation* out of the estate for services rendered by them *during* the proceedings. By statute, and as an equity receivership court, the Chapter X court has exclusive jurisdiction over the continued service of *all* fiduciaries and over the "reasonableness" of *all* compensation paid to *all* fidu-

[3] Questions 1, 2 and 3 presented here are identical to the three questions presented in the Petition for *Certiorari*. Questions 4 and 5 are subsidiary questions comprised in Questions 2 and 3, and are set forth for clarity and emphasis, pursuant to this Court's Rule 40(1)(d).

ciaries. In exercising that jurisdiction, is there a *double standard* which (a) requires the court to apply a strict *federal* standard of fiduciary conduct to those fiduciaries *alone* who were "disinterested" at the *commencement* of the proceedings, (b) yet permits the court to apply a different, looser *state* standard of fiduciary conduct to those fiduciaries who serve *during* the proceedings, but who were *not* "disinterested" at the *commencement* of the proceedings?

3. Does the payment of compensation to the officers of a Chapter X debtor in possession *week-by-week during* the proceedings, *exempt* such officers from the mandate and bar of § 249—that "No compensation or reimbursement shall be allowed to any * * * person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold * * * stock [of the debtor] * * *."—although payment of compensation to such officers *in gross at the winding-up* of the proceedings, would be absolutely barred by § 249?

4. Assuming the mandate of terminating *future* weekly compensation under § 249: Does § 249 also mandate recoupment and restitution of *past* compensation paid out of the estate weekly during the Chapter X proceedings and prior to termination of future compensation?

5. Does a Chapter X court have power to remove from office a director or officer of a debtor in possession, on grounds of misconduct in office during the Chapter X proceedings?

Statement of the Case

The Debtor was incorporated in Pennsylvania on August 7, 1951, to operate a "farmers' market." Its sole assets are land and buildings at a highway junction in Nazareth, Pennsylvania. It rents space inside the buildings to merchants, and an outside race-track for stock-car racing. Its sole earnings are those rents (R. 44-5, 51).

The Debtor was organized by the "Philadelphia Group," a joint venture which had acquired the realty on April 17, 1951, and conveyed it to the Debtor on September 26, 1951, at their cost. The Debtor paid the Philadelphia Group part of the price by an original issue of 20 shares (of nominal book value, and the only outstanding stock until February of 1953). On October 17, 1951, the Philadelphia Group sold their entire interest (including the 20 shares) to John Malakoff, at a profit. From April of 1951, when he had bought a 1/4 interest in the venture, to 1952, Malakoff personally paid the Philadelphia Group, in irregular installments, most of the purchase price of the realty and the stock; eventually, they forgave him the balance due (R. 51-57, 230-1).

Malakoff undertook a clumsy real estate "syndication" or promotion.[1] Between April of 1951 and April of 1953, he sold "shares" in the Market to at least 41 persons. Every purchaser paid Malakoff personally (some by cash, some by check, some by credit against Malakoff's debts); he received substantially more from those purchasers than he paid the Philadelphia Group. In turn, Malakoff paid "dividends" to the purchasers, in regular monthly installments out of his own bank accounts, mostly computed at 20% per year on their original advances to him. Virtually all the transactions occurred in New York, where Malakoff and most of

[1] *See Symposium*, The Why and the How of Real Estate Syndications, 14 The Record of Assn. of Bar of City of N. Y. 45 *et seq.* (1959); Berger, Real Estate Syndication, 69 Yale L. J. 725 (1960).

the purchasers resided. The prices and other terms varied radically over the two-year period. Generally, the "shares" were described as $n/200$ of the Market; most were sold for $1,000 per "share," though some were sold for as little as $333 per share. Until the delivery of the stock certificates early in 1953, most of the purchasers held only letter-receipts from Malakoff as evidence of their payments and other terms of their transactions with him (R. 185-192, 231-2). Of the several forms used, the most common—drafted by respondent Weinstein, as Malakoff's lawyer (R. 123-5)—was the following:

> "You understand, of course, that *all of the authorized stock* of The Nazareth Farmers and Auction Market Inc. [*sic*] which owns the Market *has been issued to me*. Under our arrangements, I am obliged to you for a proportionate share of *my* earnings, dividends, liquidating or otherwise and profits from the Market as I receive them. For your information, I may say that the dividends have been declared at the rate of Twenty per cent. (20%) per annum, payable monthly. * * *
>
> "In the course of my management of the Market, I may cause to be issued to you shares *of my present stockholdings*. On the other hand, I may cause the dissolution of the Corporation and arrange for the formation of a limited partnership and your shares will be applied as your contribution with a corresponding proportionate interest. At all events, the method of operation is to remain solely in my hands. * * *
>
> "It is contemplated that the construction, performance, and execution of our understanding shall be governed by the Laws of the State of New York." (R. 186-7; *emphasis supplied.*)

Not later than June of 1952, Malakoff took control of the Debtor. He became its president and a director; his employee, respondent Fried, became secretary-treasurer, a director, and general manager (R. 56, 154-7, 231). In August of 1952, Fried (acting for the Debtor as landlord) leased the race-track to Fried's then-partner for ten years; in April of 1953, Fried's corporation (Nazareth Enterprises, Inc.) took over the lease as tenant (J. Fried Creditor; Margolis's Exh. C, R. 560, 7413; Examiner's Exh. 1, R. 556, 8333).

By early 1953, Malakoff was in financial trouble. Between February and April, he caused the Debtor to issue and deliver stock certificates (co-signed by Malakoff and Fried) to evidence the "shares" Malakoff had sold. The Debtor's charter authorized the issuance of 200 shares, and Malakoff had represented the "share" total as 200; in fact, he oversold, and he caused the issuance of at least 316 shares (R. 57, 185-7, 232).

By May of 1953, Malakoff's "dividend" checks had stopped. The stockholders, previously dormant, then interceded. In June, Malakoff surrendered his own stock (the original 20 shares) to the Debtor, and Malakoff and Fried resigned as officers and directors. At a stockholders' meeting on June 29, 1953, Weinstein was elected president and a director. He continued Fried's service as general manager (R. 187-9).

The Debtor was and is solvent in the bankruptcy sense. The major problem was to determine the ownership of the Debtor's stock (R. 1-14; Examiner's Exh. BY; R. 516-524, R. 9587). In effect, in order to resolve that problem, the Debtor selected the Chapter X court as a convenient forum with sweeping jurisdiction over all 11 parties and the subject matter.

On September 28, 1953, on a voluntary petition verified by Weinstein as president, the Debtor entered Chapter X reorganization proceedings in the Southern District of New

York (R. 1). The *ex parte* orders signed that day continued the Debtor in possession, provided that the Debtor:

> "by Arnold A. Weinstein and Jerome Fried be authorized, directed and empowered to operate the business and manage the property of"

the Debtor, and authorized payment of a salary of $100 per week to Fried as general manager (R. 11-12, 15, 17). Later orders in 1955 and 1956 increased Fried's salary to $150 and then $200 per week, and authorized a salary of $50 per week to Weinstein, too (R. 21, 23, 38). Their weekly paychecks, like all other checks drawn on the Debtor's regular checking account, are countersigned by a referee in bankruptcy, Hon. John E. Joyce (R. 18, 247).

The Parties: Petitioners Wolf and Davidson are the nominal owners and holders of 117 shares of stock of record of the Debtor; their principals include Wilson D. Rehrig, Martin H. Philip, and Petitioner Katzenell, the beneficial owners. Between June 27, 1957, and December 9, 1960, Wolf and Davidson acquired those 117 shares from eight stockholders of record, namely: Petitioners Hull and Katzenell, and S. Forman, Kane, Kanter, Pollak, and Saul; Katzenell retained a partial interest in his own shares, and acquired a partial interest in the Kanter shares (R. 49, 195). (Petitioners and their principals are sometimes collectively referred to in the proceedings and in this brief as "Wolf" and the "Rehrig Group".)

Respondents Weinstein and Fried are stockholders of record who first acquired shares from Malakoff in 1951 (R. 120, 156). Beginning on May 7, 1957, Weinstein and Fried acquired for themselves and for Laupheimer and Mrs. Blanche Waldman (Weinstein's sister) 35 shares of stock of record from six stockholders, namely: B. Clark, D. H. Clark, Karapontso, Manoochehrian, Masur, and Treat (R. 441-2, 290-4, 470). Beginning January 26, 1961, Fried's associate, Frank V. Thompson (R. 470), acquired 31 shares

of stock of record from seven stockholders, namely: Bikales, Bluestone, H. Forman, Noire, G. Schwartz, H. Schwartz, and T. J. Schwartz. Weinstein, Fried, Fried's father (Aaron), and Laupheimer own 21 shares of record acquired from Malakoff prior to 1953. Thus, the "Weinstein-Fried Group" now own an aggregate of at least 87 shares of record.

The Debtor is governed by a board of three directors, elected by cumulative voting by the stockholders. On June 29, 1953, the Debtor's stockholders of record elected Weinstein, Kanter, and Margolis directors. On August 24, 1953, Margolis resigned, and the directors substituted Laupheimer as the third director. (Saul General: Examiner's Exh. 1; R. 168 [not printed].) Weinstein, Kanter, and Laupheimer continued to serve as directors after the Chapter X proceedings commenced. The next election was called by petitioners and was held on August 4, 1958; the stockholders of record elected Weinstein, Philip, and Danciger directors. That election was not confirmed by the District Court until June 14, 1960[2] (R. 226-7, 495-6).

The controversy in No. 27000 involves the relative distribution of the Debtor's shares—equity and votes—between the two factions. The Rehrig Group's 117 shares of record as issued in 1953, are 37.025% of the total 316 shares of record; the Weinstein-Fried Group's 87 shares are 27.532% of those 316 shares. Under the District Court's order of December 8, 1960, and assuming the same allowances to the Margolis Group as made by the Court of Appeals, the Rehrig Group would hold 31.107% of the Debtor's stock, and the Weinstein-Fried Group would hold 34.474%. Under the Court of Appeals' decision of November 9, 1961, the Rehrig Group would hold 19.591% of the Debtor's stock, and the Weinstein-Fried Group would hold 38.188%.

In No. 26362, petitioners have proceeded representatively, as stockholders; by contrast to No. 27000, No. 26362 is in

[2] See Bankruptcy Act § 191, 11 U. S. C. § 591, 52 Stat. 893 (1938).

the nature of a derivative suit brought on behalf of the Debtor against Weinstein and Fried *qua* corporate fiduciaries.[6]

The bitter contests between the two factions began shortly after August 28, 1956, when a fire virtually destroyed the Nazareth Market. Rehrig was a tenant of the Debtor in the Market before the fire, and afterwards until June 13, 1962, when fire (the third during these proceedings) again destroyed the portion of the Market occupied by Rehrig. The disputes over management and Rehrig's tenancy were summarized by Judge Sugarman in his findings of November 7, 1960:

> "During the course of the ensuing proceedings certain disputes arose between the management of the debtor and a group of alleged shareholders, colloquially referred to as the 'Rehrig group', stemming from the alleged refusal of the management of the debtor to give Rehrig, a meat merchant in the market, fair consideration as to space, rental, etc. Control of the debtor was sought to be obtained *by each side* by an acquisition of the interests of various putative stockholders." (R. 246; emphasis supplied.)

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[6] Bankruptcy Act, § 206; 11 U. S. C. § 606; 52 Stat. 894 (1938).

In 1955 and 1956, the District Court issued "bar orders"[7] which compelled all the stockholders to file proofs of claim to stock interests in Nazareth (R. 45, 229). The Debtor's answers (verified by Weinstein as president) objected to the allowance of every single stock-claim and asked cancellation of all the stock. Alternatively, the Debtor counterclaimed for the subscription price of any stock which might be validated (*Id.*; *see, e.g.*, R. 177). Malakoff had died, insolvent, in 1955; he was never a party to the Nazareth proceedings.

Those bar orders also referred the stock interests and creditors' claims to John E. Joyce, Referee in Bankruptcy, to hear and determine. In 1957, Referee Joyce tried the five stock-claims of the "Margolis Group" alone.[8] On March 18, 1958, Judge Sugarman revoked the general reference to Referee Joyce with respect to the 36 stock-claims (as well as six creditors' claims) then still undetermined by Referee Joyce.[9] Judge Sugarman consolidated those claims, and himself undertook trial thereof. The trial consumed 86 trial-days between May 19, 1958, and May 7, 1959; more than 50 witnesses testified; the stenographers' minutes aggregate 9638 pages; the exhibits fill several file drawers (R. 2456).

On October 3, 1956, the District Judge had appointed Charles Seligson Examiner in the Nazareth proceedings (R. 46).[10] The Examiner actively participated in examining wit-

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[7] See Bankruptcy Act, § 196; 11 U. S. C. § 596; 52 Stat. 893 (1939); *see also*, 6 Collier on Bankruptcy (14th ed.) ¶¶ 9.03, 9.04.

[8] The "Margolis Group" (viz., Benjamin Margolis [recently deceased], Ida Mae Margolis, Sarah Kason, Wm. McK. Shongut, and Bernard Ungar) were five of the 41 stockholders of record who had filed proofs of stock interests in 54 shares. *See* No. 26862, R. 586, 597-8.

[9] *Pursuant to* Bankruptcy Act, § 168; 11 U. S. C. § 568; 52 Stat. 888 (1938). Charles Seligson is Professor of Law at New York University, and is a member of the Supreme Court's Advisory Committee on General Orders in Bankruptcy. (184 F. Supp. 7.)

nesses and introducing evidence at the trial before Judge Sugarman; moreover, on April 19, 1960, after the parties had submitted their briefs, the Examiner submitted a 236-page Report, which reviewed the evidence and which recommended findings of fact and conclusions of law (R. 44-217). On October 19, 1960, Judge Sugarman filed his findings and conclusions (R. 229); and on December 8, 1960, Judge Sugarman signed an order thereon (R. 260). The District Judge treated the Examiner's Report as a master's report, and adopted the Examiner's recommended findings and conclusions—but only after the District Judge's own independent and thorough review of the record (R. 492, 245-6). Subsequently, the Court of Appeals likewise treated the Examiner's Report as a master's report adopted by the District Court (R. 590, 593, 594).

The District Court's Order of December 8, 1960, allowed *all* 36 stock-claimants to participate in the estate, according to the "net fair value" of their respective "investments" (*i.e.*, their advances to Malakoff, less "dividends" received). That Order also denied all 36 of the Debtor's counterclaims for the stock subscription prices (R. 260-4).

Three appeals were taken, by Weinstein and Fried (each acting individually) and by Petitioners. Weinstein's appeal sought disallowance of the three stock-claims of Kanter, Katzenell, and S. Forman (owned by the Rehrig Group). Fried's appeal sought disallowance of those three stock-claims and a fourth, Danciger's. Wolf's appeal sought a different formula of distribution, not a disallowance of particular stock-claims (R. 13566-70 [*not printed*]). The Debtor did not appeal; however, on Weinstein's authorization, the Debtor, as appellee, attacked the District Court's allowance of 10 of the 36 claims involved in No. 27000, including the four claims involved in the Weinstein-Fried appeals. Neither the Debtor nor any other party appealed from the denial of the Debtor's counterclaims for the stock subscription prices (by contrast to the allowances and awards of stock interests).

On November 9, 1961, the Court of Appeals reversed the District Court, and effectually adopted the rationale of Weinstein, Fried, and the Debtor (*see* R. 47-49, 192-4). The Court of Appeals set up two classes of stock-claimants. Five stock-claims (Danciger, H. Forman, S. Forman, Katzenell, and Manoochehrian), and most of a sixth (Kanter), were disallowed; that stock was cancelled. The other 30 stock-claims were allowed according to the respective sums advanced to Malakoff, but without deduction of "dividends" (R. 586-600).

In sum, both the District Court and the Court of Appeals, purporting to apply Pennsylvania corporation law, held *all* the Debtor's outstanding stock absolutely void for lack of consideration to the Debtor. Then, on general principles of "equity," without further reference to state law, and as though there were no corporation, both courts undertook to distribute the assets of the Debtor anew. Shares of stock were to be issued proportionate to the prevailing stock-claimants' equitable "interests" in the Debtor's assets. Free of any applicable *law*, the courts below differed substantially in their respective views of the facts and the "equities."

The evidence and findings of particular materiality are as follows:

1. *Debtor's Acquisition of Market:* The Philadelphia Group[10] obtained an option to the Market on March 13, 1951, and purchased the Market on April 17, 1951, for an adjusted net cost of $66,232.99; the nominal purchaser was Richard Realty Co., a corporate "dummy" for the joint venture. They re-conveyed the Market to another Philadelphia Group corporate dummy, Kipling Realty Co., on May 14, 1951. They had advanced $47,732.99 in cash at and before the closing, and assumed liability on two mortgages; later,

[10] The "Philadelphia Group" included Maurice Malakoff (John's brother), Edward Malakoff (Maurice's son), Milton R. Zoloth (Edward's brother-in-law), and Morris Soble. Zoloth and Soble became the first two Nazareth stockholders. (R. 52-3, 280-7)

they advanced additional moneys for improvements, opening bank deposit, *etc.*, and they deducted depreciation, amortization, operating deficits, *etc.*, from their capital account. As of August 7, 1951, their net cash investment in the Market was $58,635.92, which they had recapitalized to show $57,135.92 in "loans" owed to individual members, and $1,500 in "capital" (R. 51-3, 230-1, 282-3, 286-7, 588; Saul General Examiner's Exh. G, R. 531, 156; Exh. J., R. 537; Exh. BU, R. 507; Exh. BY, R. 511-2, 9587).

On August 1, 1951, the Philadelphia Group organized the Debtor; the certificate of incorporation was issued in Harrisburg on August 7, 1951. The articles of incorporation show "stated capital" of $120,000, and "paid-in capital" of $1,500. On August 9, 1951, the Debtor—controlled by the Philadelphia Group—agreed to buy the Market from Kipling (the venture's dummy) *at Kipling's cost.* The adjusted book value (cost) of the Market was then $75,227.39. The consideration for the Market was twofold: (a) the Debtor's issuance of 20 shares of stock to the Philadelphia Group, capitalized at $1,500, and (b) the Debtor's assumption of certain liabilities owed by the Philadelphia Group, including the two mortgages owed to third parties and the $57,135.92 in "loans" owed to its own members. On August 8, 1951, 20 shares of the Debtor's stock were duly issued to Soble and Zoloth (members of the Philadelphia Group). On September 26, 1951, pursuant to the August agreement, the Market was conveyed to the Debtor (R. 53-5, 231, 588-9; Saul General Examiner's Exh. I, R. 532-4, 168; Exh. BY, R. 512-3, 9587).

The Debtor, as a separate corporate entity, *never* had any obligation to the Philadelphia Group or to Malakoff for any profit, promotional services, or goodwill incident to the conveyance of the Market to the Debtor.

2. *Malakoff's Interest:* In March of 1951 (between contract and closing) the Philadelphia Group sold John Malakoff a 1/4 interest in the venture. By August 7, 1951, he had advanced $17,489 to them, which sum was included in the

$57,135.92 in "loans payable" by the venture and later by the Debtor (R. 51-2, 56, 230; Saul General; Examiner's Exh. J., R. 537; Exh. BU, R. 507; Exh. BY, R. 512-3, 9587).

In July of 1951, the Philadelphia Group agreed to sell the entire Market to Malakoff (R. 52, 231, 588). The transaction shows their financial sophistication. The sale was consummated on October 17, 1951—precisely six months after their acquisition of the Market on April 17th. The contract spoke only of the 20 shares of Nazareth stock then issued and outstanding and owned by Soble and Zoloth (as members of the Philadelphia Group). The purchase price of the stock—capitalized at $1,500 on the Debtor's books—was $32,853.08, payable $2,853.08 down on contract, and the balance in ten equal monthly installments of $3,000 each—thus spread over two fiscal periods (R. 55, 231, 588; Saul General; Debtor's Exh. F, R. 540-1, 90). In addition, Malakoff personally assumed liability to the Philadelphia Group for the "loans payable" to them; by June 30, 1952, the Debtor's books showed those loans as owed to Malakoff himself, and the Philadelphia Group had discharged their claims against the Debtor (R. 56; Saul General; Examiner's Exh. BY, R. 514, 9587). On or about October 17, 1951, the two stock certificates for the original 20 shares were duly indorsed in blank by Soble and Zoloth. As security, the Philadelphia Group retained those stock certificates, and the entire corporate outfit as well, in escrow or purchase-money pledge (R. 55-6).

The District Judge found that the total price of the Market to Malakoff was $66,000 (the contractual purchase price of the Market to the Philadelphia Group in April) "plus an unresolved amount" (R. 231). The Examiner found that the total price to Malakoff was $89,989 (*i.e.*, $32,853.08 for the stock, plus $57,135.92 in "loans" owed by the Debtor and assumed by Malakoff *vis-à-vis* the Philadelphia Group [including the $17,489 actually advanced by Malakoff and invested in Nazareth prior to August 7th]) (R. 52, 56). The

upshot was an intended profit to the Philadelphia Group of about $30,000—all payable by Malakoff on the sale of the stock, and none payable by the Debtor on the sale of the realty.

In 1951 and 1952, Malakoff paid the Philadelphia Group $60,521.84, in irregular installments: $17,489 between April and August of 1951; $17,500 between September 13 and October 16, 1951; $14,500 between October 24, 1951, and February 15, 1952; and $11,032.84 in September and October of 1952 (R. 56-7; Saul General: Examiner's Exh. J, R. 537-9). Malakoff was always in arrears on his contractual installment obligations. Nevertheless, the Philadelphia Group did not foreclose the pledge; indeed, when they released the stock certificates and corporate outfit, in December of 1952, they forgave Malakoff the balance then due to them, almost $30,000—their entire anticipated contractual profit on the transaction (R. 57).

On June 17, 1953, Malakoff resigned as president and a director of Nazareth (R. 188). That day, he surrendered *to the Debtor* the original 20 shares he had purchased from the Philadelphia Group (Soble and Zoloth) in October of 1951. He indorsed the stock certificates:

> "I hereby assign the within certificate/shares to the corporation. /s/ John Malakoff"

(Saul General: Examiner's Exh. H, Ctfs. 1, 2; R. 166 [*not printed*]; R. 185-6). By then, Malakoff had already caused the issuance and delivery of all the outstanding stock certificates for 316 shares to all 41 stock-claimants (R. 186).

As of June 30, 1953, the Debtor's books showed receivables from Malakoff to the Debtor of $15,710.63, and loans payable by the Debtor to Malakoff of $68,442.92; *i.e.*, net payables owed to Malakoff of $52,732.29 (R. 57; Saul General: Examiner's Exh. BY, R. 518, 9587). Between November of 1951 and April of 1953 (the entire period of Malakoff's control

of the Debtor), Malakoff had personally advanced $21,389.43 to the Debtor, and had withdrawn $22,510.33 from the Debtor, for a net debit of $1,198.90. The record shows no compensation or other payments to him except the aforesaid withdrawals (Saul General: Debtor's Exh. L; R. 549-551). From April of 1951 through June of 1953, the Debtor maintained a regular checking account at a Nazareth bank, which account is reflected on the Debtor's books. There was no commingling of funds of the Debtor and Malakoff, except as shown in the loan and exchange accounts between the Debtor and Malakoff on the Debtor's books (R. 189, 191-2).

On July 2, 1953, Malakoff released all his claims against Nazareth (R. 57; Saul General: Debtor's Exh. Q, R. 554-6, 8899). It was not until fiscal 1957 that the Debtor's management effectuated that release on the books by "vacating" the $68,442.92 in loans payable to Malakoff, with this explanation by the Debtor's accountant:

> "* * * Upon investigation, the officers of Debtor have determined that said sum was primarily a bookkeeping entry, not a true indebtedness. * * *"

The sum was credited to *earned surplus*, not to paid-in capital; and the receivables of $15,710.63 still appear on the Debtor's books as owed by the insolvent, deceased Malakoff (Saul General: Examiner's Exh. BY; R. 518, 522, 9587).

3. *Valuation:* The record contains no appraisal or expert valuation of the Market, the realty, or the capital stock of the Debtor at any time, nor any judicial valuation.

4. *Variation of Investment Contracts:* Malakoff's relationship with the 41 stock-claimants varied materially from the time he first became interested in Nazareth in March of 1951 until his last delivery of stock certificates in May of 1953. Until December of 1952, when the Philadelphia Group released the stock-certificate book, Malakoff could not deliver stock certificates to his investors. Instead, he used a variety of letter-receipts (R. 186-7).

(a) In March and April of 1951, when Malakoff had a $\frac{1}{4}$ interest in Nazareth, he invited at least six investors to participate. His estimated cost of $\frac{1}{4}$ was $12,000 (he advanced $12,489 of the $47,732.99 cash outlay by the Philadelphia Group to close title on April 17, 1951). To allow for his own promotional share, he used a base of $16,000. Three of those investors remain stockholders at present, *viz.*: Kanter, G. S. Klein, and Samet, who contributed $4,000, $2,000, and $2,000 (respectively), for which Malakoff promised them $\frac{1}{4}$, $\frac{1}{8}$, and $\frac{1}{8}$ of his $\frac{1}{4}$ interest, or $\frac{1}{16}$, $\frac{1}{32}$, and $\frac{1}{32}$ of the venture (respectively) (R. 230, 56, 60, 64, 67; Saul General: Debtor's Exh. K; R. 547). Those transactions were characterized by a letter Malakoff wrote to Samet much later, on June 12, 1952:

> "It is understood that you have invested in the sum of two thousand dollars ($2,000.00) which is a part share ($\frac{1}{32}$) in a deal, which is known as 'Nazareth Market' * * *." (R. 64)

(b) In July of 1951, when Malakoff agreed to purchase the entire Market from the Philadelphia Group for about $90,000, he began to sell participating interests or shares of 1/200 at $600 per share; 150 of the 200 shares would yield the purchase price of $90,000, and leave him $\frac{1}{4}$ as his promotional share. This arrangement was characterized by his letter-receipt to Katzenell, on September 4, 1951:

> "I hereby confirm receipt of amount totalling Thirty Thousand ($30,000.00) for $\frac{1}{4}$ share of Farmers Market at Nazareth (50 shares of total of 200 issued)." (R. 178)

(c) About August of 1951, with the prospect of inviting investments from strangers, Malakoff promised, not only "participation" in Nazareth, but income of 20% per year, payable monthly; and he raised the price to $1,000 per share. Now he used a new form of handwritten letter-receipt, which spoke of an "escrow" of moneys received; *e.g.*:

> "Please be advised that I am holding in escrow the sum of Four thousand dollars which represents one-fiftieth (1/50th) ownership in the Nazareth Farmer's & Auction [*sic*] Market, in Nazareth, Pennsylvania.
>
> "At the present time the return on your investment is twenty per cent (20%) per annum, payable monthly. As the net income increases your return will increase proportionately." (Masur: Cl's 81; R. 566, 390; *See* R. 79)

(d) About mid-September of 1951, Malakoff abandoned the "escrow" form and began to use the "long-form" letter-receipt for most of the stockholders; many of the prior investors, too, later received that form. Typically, that form read as quoted above on page 6.

(e) Eventually, between February and May of 1953, the stockholders all received stock certificates from Malakoff; and Malakoff stopped using any form of letter-receipt. Some of those late-comers who took stock certificates as security for loans to Malakoff, as payment for antecedent debts by Malakoff, or in exchange for other investments obtained from or through Malakoff, had special written agreements. The late-comers who paid cash, received nothing but the stock-certificates, some (though not all) of which were indorsed with Malakoff's guaranty; *e.g.*:

> "This certificate represents two $1,000 shares ($2,000—). At the present time the dividend is guaranteed at 20% per annum payable in equal monthly instalments on the first day of each month. /s/ John Malakoff." (R. 82)

Thus, there was no single scheme followed by Malakoff over the two years of his Nazareth adventure. The price of the stock, the time of investment, the written agreements, the return in "dividends", the type of consideration: all varied substantially; and in several instances Malakoff changed his

investment contracts with the claimants. Moreover, when the stock certificates were actually issued and delivered, neither the dates nor the numbers on the certificates were correlated to the sequence of investments or agreements with Malakoff. The Examiner stated that it was impossible to identify which of the issued shares fell within the "over-issue" (R. 210-24); and neither the District Court nor the Court of Appeals made any finding or conclusion identifying the "overissue". Finally, both Courts below focused on the cash "investments" made by the stock-claimants, and disregarded their agreements with Malakoff.

5. *Tracing of Funds—Intentions of Stock-Claimants—Malakoff's Capacity.* There are two major factual discrepancies between the findings of the Court of Appeals and the findings of the District Court.

(a) The District Court found that *all* the stock-claimants had dealt with Malakoff *individually*. By contrast, the Court of Appeals found that the prevailing stock-claimants had dealt with Malakoff *representatively* (*i.e.*, as *trustee* for those stock-claimants), and that those stock-claimants who had dealt with Malakoff *individually* were entitled to nothing.

(b) The District Court found that the stockholders' advances had all been commingled in Malakoff's bank accounts with other moneys (*i.e.*, moneys of his own and moneys of investors in transactions other than Nazareth), and that tracing of their advances into or for the Nazareth Market was unproved and impossible on the record (except $8,000 advanced by Kanter, G. S. Klein, and Samet in March and April of 1951, and paid over to the Philadelphia Group [R. 56, 230]). By contrast, the Court of Appeals found that the purchase price of the Nazareth Market (paid by Malakoff to the Philadelphia Group) could be, and actually had been, traced to the *prevailing* stock-claimants' advances to Malakoff, but could *not* be so traced to moneys advanced to Malakoff by the *disallowed* stock-claimants. Moreover, the Court of Appeals did not distinguish between the earlier

advances *actually* so traced, and the later advances which should have been—but had *not* actually been—so identified with the purchase price or other corporate purposes.

Judge Moore stated the findings of the Court of Appeals, as follows:

> "* * * One group of investors paid Malakoff by check, credit or cash various sums to purchase an interest in the Nazareth Market. The money was solicited *for this purpose* by Malakoff *as the promoter* of the enterprise and was *not intended* to be loans to Malakoff personally or to be used generally by him in his many business operations. The funds *should have* reached the Debtor's treasury and have been the consideration required by Pennsylvania law [footnote] to support the valid issuance of the Debtor's shares. * * *". (R. 591; *emphasis supplied*)

> "* * * The Market property is sufficient to support a valid stock issue to those entitled thereto. The sellers (Philadelphia group) have been paid for that property *by Malakoff*. Malakoff in turn obtained the money *for this purpose* from those who *thought* that they were to receive an interest in the Nazareth Market. * * *" (R. 592; *emphasis supplied*)

> "Although the findings of fact of the Examiner may be accepted almost in their entirety, his conclusions are at variance with the equitable principles applicable here. The *Examiner treated Malakoff as the owner* and operator of the Debtor and *each claimant as having purchased his interest from Malakoff*. This *erroneous assumption* made it possible for the Examiner to accept the stock claims of all claimants who had received stock from Malakoff on the theory the stock transfers from Malakoff rested upon adequate consideration if the Stock Transfer Act's defi-

nition of 'value' were satisfied. * * *." (R. 593; *emphasis supplied*)

The findings of the District Judge include the following:

"13. Every claimant acquired his or her shares of the debtor's stock by means of transactions with or through said John Malakoff or his agents." (R. 231)

"14. John Malakoff commingled funds received by him from others for investment in the debtor with *his own funds* and with those of other corporations controlled by him." (R. 231; *emphasis supplied*)

The findings of the Examiner include the following:

"90. There are certain findings and conclusions of *fact* which the Examiner deems significant in determining the principles and rules of law which should be applied in the determination of the question as to who are the stockholders of the debtor corporation. Those findings and conclusions are beyond cavil and can be stated without qualification. They are as follows, * * *:" (R. 190)

"(8) *None of the payments* made by any of the claimants-stockholders, representing investments in Nazareth, *was made directly to the debtor*. Almost all of the checks were drawn or endorsed over to Malakoff or Helen Bernstein [Malakoff's assistant]. *There is nothing in the record which establishes that any of these payments became an asset of Nazareth even indirectly.*" (R. 192; *emphasis supplied*)

"92. * * * The [Debtor's (*i.e.*, Rosen's)] memorandum, however, argues that Malakoff acquired an interest in Nazareth for the account of those who invested in Nazareth through him. Therefore, so the argument runs, an interest in Nazareth may be predi-

cated only on the basis of a *present consideration* given to Malakoff for the *express purpose* of acquiring an interest in Nazareth. This conclusion does not necessarily follow from the premise that Malakoff purchased an interest in Nazareth for the account of those who invested in Nazareth through him. Since Malakoff and not the debtor was the direct recipient of all consideration paid for all of the shares of stock issued to the claimants-stockholders, and *no claimant has attempted to trace, from Malakoff to the debtor, the consideration he or she paid to Malakoff*, none of the claimants-stockholders can prove that he acquired any of the shares in strict conformity with law." (R. 193; *emphasis supplied*)

The extent to which the relevant findings of the District Judge and the Examiner depended upon the credibility of the witnesses, and particularly the stock-claimants themselves, may be seen in the case of Weinstein himself. Weinstein had bought seven shares of Nazareth stock in September of 1951 (R. 120). He not only received the "long form" letter-receipt (R. 186-7, *quoted supra*, p. 6); as Malakoff's lawyer, he had drafted that form (R. 122-5). In 1955, Weinstein filed a sworn proof of claim, alleging:

> "That John Malakoff, the then President of the Debtor, and as such, fraudulently represented to Claimant on or about the 12th day of September 1951, that he was the President of the Debtor Corporation, that the said Corporation was authorized to issue Two hundred (200) shares of stock, that said stock was duly *issued to him* and that 7 of *such* shares were being *sold to Claimant* for $7,000.00. On the basis of the foregoing representations, deponent issued his check to John Malakoff as above stated on or about the 19th day of September 1951 * * *." (R. 120; *emphasis supplied*)

Nevertheless, in 1958, upon interrogation by the District Judge, Weinstein testified:

> "Q. Mr. Weinstein, I think you understand me. Leaving out the fact that there was indecision at that time as to what future form the enterprise would take, I ask you as a lawyer who drew that document what you believe any reasonable person would get, what impression they would get, as to the ownership of a venture by reading the second paragraph in the language that you coined. A. The impression that somebody would get, your Honor, is that John Malakoff had had all of the stock issued to him and that he owned it.
>
> "Q. And that he was selling it, is that right, in some form? A. Yes, sir.
>
> "Q. But am I to understand your testimony to be that, notwithstanding the employment of that language in that agreement, the impression that you got from John Malakoff was different? A. Yes, sir." (R. 362-3).

6. *Dividends:* Beginning about September of 1951, Malakoff paid "dividends" of 20% per year to most (though not all) of the stock claimants, usually (though not invariably) based on the actual cash advances made by the stock-claimants to Malakoff for investment in Nazareth. The "dividends" continued until May of 1953, though some of the checks were dishonored as early as March due to insufficient funds. Those "dividends" were paid out of Malakoff's personal checking accounts, except during February and March of 1953 when they were paid out of a corporate account separate from the Debtor's regular account and fed entirely by Malakoff (R. 189-192, 232).

The District Court treated those "dividends," paid out of Malakoff's personal moneys, as "return of capital," and

deducted the aggregate receipts by the stock-claimants from their advances to Malakoff in determining each "net cash investment" in Nazareth (R. 209-212, 241, 262). By contrast, the Court of Appeals treated the "dividends" as trust funds traceable to the prevailing stock-claimants' advances to Malakoff, and as diversions of corporate funds; the aggregate receipts by the prevailing stock-claimants were *not* to be deducted from "capital" or investment in Nazareth, but were to be recouped by the Debtor from the stockholders by offset against future "distributions" payable by the Debtor (R. 598-9).

Judge Moore wrote:

> "* * * These 'dividends' were paid in Ponzi-like [footnote] manner out of new money *received from investors* in the Nazareth Market. * * *" (R. 590; *emphasis supplied.*)

(By "investors," Judge Moore meant the prevailing stock-claimants alone. *See* R. 591, 593-4, 598-9.)

By contrast, Judge Sugarman found:

> "17. The so-called dividends received between August 7, 1951 and September 28, 1953, both dates inclusive, by the *persons who acquired legal or beneficial interests* in the debtor represented the return to them by John Malakoff *individually*, directly or indirectly, of moneys advanced by such persons, directly or indirectly, for or against their respective interests in the debtor." (R. 232; *emphasis supplied*)

And the Examiner found:

> "(7) The dividends aggregating $36,268.02 paid to the stockholders, with the exception of some dividends paid to stockholders in February and March of 1953,

> represented payments made by Malakoff from one of his personal bank accounts and *did not come from Nazareth directly or indirectly.* In February and March 1953, dividend checks were issued by Nazareth on the Second National Bank of Nazareth, Pennsylvania. The deposits in and the disbursements from this bank account were unrelated to the regular operations of the corporation. The funds deposited were supplied by Malakoff." (R. 191-2; *emphasis supplied*)

(Judge Sugarman and the Examiner, of course, are speaking of all 36 stock-claimants, not the "investors" alone.)

7. *Stockholders' Non-Participation in Malakoff's Frauds*: The District Court found:

> "12. * * * throughout the entire period of all the transactions involved in the issuance of stoc to the stock claimants herein, the debtor was dominated and controlled by him [Malakoff]." (R. 231)

Neither Court below found that any of the 36 stock-claimants involved in No. 27000 had participated with Malakoff in any fraud he perpetrated on the Debtor or on the stockholders. Neither Court found that any of the 36 stock-claimants had any actual knowledge of any such fraud until Malakoff confessed and resigned in May and June of 1953. In at least two instances, the Examiner *explicitly* found *no* such participation, *viz.*: Kanter (R. 62) and Hull (R. 146) (two of Wolf's assignors).

No. 26362

During the reorganization proceedings, Weinstein and Fried engaged in two courses of conduct which became the subject of Wolf's petitions in No. 26362, *viz.*: (1) For their own accounts and for others, they bought and sold the Debtor's stock. (2) They reduced the percentage rent payable by Fried's race-track corporation to the Debtor on the race-track gross receipts (under the lease made by Fried in 1952); and they arranged for Fried's corporation to retain the rents theretofore paid by a race-track food concessionaire to the Debtor. Here, unlike No. 27000, the facts material to No. 26362 are undisputed.

Having been stockholders, directors, and officers of the Debtor, Weinstein and Fried were not "disinterested" at the commencement of the proceedings.[11] A preliminary issue in No. 26362 is whether Fried, as the Debtor's "general manager," is a "fiduciary."

The relief sought by Wolf in No. 26362 is denial of compensation by the Debtor (*i.e.*, out of the estate) to Weinstein and Fried, and their removal from office as president and director and as general manager (respectively). The first of Wolf's two petitions came on in March of 1959 (during the stock-claims trial), and was addressed solely to denial of compensation; Wolf alleged only the trading in the Debtor's stock, and relied principally on § 249 (R. 247, 254). On January 4, 1960, the District Judge decided that § 249 mandated termination of future compensation to Weinstein and Fried—but that § 249 did not mandate recoupment of their salaries already paid, the latter issue being within the Chapter X court's discretion in equity. Trial on that latter issue was set for later in January (R. 45, 248-9). Thereupon, Wolf brought the second petition (R. 217), which added the race-track rent diversions as grounds for equitable recoup-

[11] Bankruptcy Act, § 158; 11 U. S. C. § 558; 52 Stat. 888 (1938).

ment of past compensation, and which added the prayer for removal from office on all the same grounds (R. 248, 255). A four-day trial ensued, between January 25 and 28, 1960, on both petitions, as consolidated. Meanwhile, no order was entered on the January 4th decision (R. 247-8, 255).

On June 14, 1960, the District Judge ruled, and rendered orders, on the two petitions in No. 26362. He terminated the future compensation of Weinstein and Fried—solely on the ground of their trading in the Debtor's stock, and solely on the authority of § 249—and he barred them from actively serving as president and director and as general manager (respectively).

> "The Court: I refuse to entertain any idea that will permit you [Fried] to have anything to do with the debtor, because you dealt in the debtor's securities and Congress said you cannot be compensated if you deal in the debtor's securities. Also I say that I will have nobody working in that Market without compensation or having his compensation paid by somebody else. That is a unique situation. I will have no part of it." (R. 502)

However, the District Judge declined to order recoupment or restitution of past compensation; and he deemed himself powerless to remove Weinstein and Fried formally from office (R. 249-252, 257, 494-6, 498, 501-2).

Weinstein, Fried, and Wolf cross-appealed (R. 573). On July 12, 1960, the Court of Appeals granted Weinstein and Fried a stay, pending appeal, of their *de facto* removal from office, though not of the termination of their salaries (R. 576-7, 244). On November 9, 1960, the Court of Appeals reversed the District Court both as to denial of their compensation and as to the *de facto* removal of Weinstein and Fried from office. The Court of Appeals held § 249 inapplicable, as a matter of law, and found no breach of trust by

Weinstein or Fried in their trading in the Debtor's stock during the proceedings, as a matter of law. Though omitting even to mention the race-track rent diversions (the alternative grounds of the petitions for removal from office and denial of compensation), and refusing to remand, the Court of Appeals likewise found no breach of trust by Weinstein or Fried in their rent diversions (R. 574, 582).

As noted, Wolf had alleged the race-track rent diversions as alternative grounds of both removal from office and denial of compensation. Moreover, Wolf had brought on another petition—returnable concurrently, in January of 1960, with the removal petition—which alleged the same race-track rent diversions, and which sought the Debtor's recovery of those rents and the rejection or cancellation of Fried's race-track lease. The District Judge severed that lease-cancellation petition and adjourned trial thereon *sine die* (R. 249-50, 256). He proceeded to hear evidence on the race-track matter, but only as it related to removal and compensation. In ruling on removal and compensation, on June 14, 1960, and again on November 7, 1960, the District Judge expressly declined to make any findings or conclusions on the race-track matter (R. 498-500, 249-250). In November of 1960, Wolf's lease-cancellation petition finally came on for a ten-day trial (R. 252, 256). On June 28, 1961, the District Judge decided that petition. He ruled that Nazareth Enterprises, Inc., was Fried's *alter ego*, and that they both owed the Debtor back-rents exceeding $22,000; however, he denied recovery of the food-concession rents, and he denied cancellation or rejection of the lease (R. 265-279). That District Court decision of June 28, 1961, was before the Court of Appeals when No. 26362 was argued on August 17, 1961.

On September 12, 1961, the District Judge entered an order on his June 28th race-track decision. Weinstein, Fried and his corporation, and Wolf cross-appealed (No. 27248; *see* 303 F. 2d 152). During the pendency of those appeals (in No. 27248) the Court of Appeals handed down its deci-

sions in No. 26362 and No. 27000, on November 9, 1961, Judge Friendly stated:

> "* * * the court may consider, in an appropriate case, that a purchase or sale of stock by a person not within § 249 requires reduction or even elimination of compensation from an estate under the court's supervision, or removal of such person from office. * * *" (R. 581)

The Court of Appeals granted no such relief, and refused remand, notwithstanding Wolf's petition for rehearing (R. 585). (*See also* 303 F. 2d 152.)

The evidence and findings of particular materiality are as follows:

1. *Fried as "Fiduciary":* The relief sought in No. 26362, both statutory and non-statutory, predicates that Fried, as the Debtor's general manager, is a "fiduciary" of the Debtor, the stockholders, and the Chapter X court. Fried denies such status. No such issue is raised by Weinstein, whose duties and powers, as president and a director, are defined in the Debtor's By-Laws (Saul General: Examiner's Exh. 1; R. 168 [not printed]). However, those By-Laws are silent as to a general manager.

The District Judge has explicitly ruled that both Weinstein and Fried were "fiduciaries" for purposes of Wolf's petitions in No. 26362 (R. 43, 491, 251). Numerous petitions and orders filed during the proceedings, especially those relating to Fried's compensation, describe his duties and powers (R. 9-12, 15, 17, 21-2, 29-30, 34, 38). Interrogated by the District Judge, Fried himself summarized his actual sharing with Weinstein the management of the Debtor's business:

> "The Court: Mr. Fried, how often is Mr. Weinstein at the Market?
>
> "The Witness: At least once a week.

"The Court: In the interim, when he is not at the market, who operates the business, and manages the property of the debtor?

"The Witness: I do, sir." (R. 485-6)

Thereupon, Judge Sugarman stated, on June 14, 1960, in rendering his decision:

"The Court: The only difference between you and Mr. Weinstein is that you [Fried] claim you were a mere menial employee and not a fiduciary, but from my knowledge of this proceeding over the past number of years, my visit to the Market, and so on, you were substantially more than a mere employee. You were no cop in the parking lot. You ran the business while Mr. Weinstein wasn't there. As you admitted, you operated the business and managed the property of the debtor. The fact that you consulted and got approval from the directors does not diminish your status in the structure of the debtor. You were the managing agent." (R. 487)

2. *Trading in Debtor's Stock:* Weinstein and Fried have stipulated that they had purchased stock of the Debtor during the Chapter X proceedings, and subsequent to the entry of orders authorizing the Debtor to pay them compensation for services rendered to the Debtor, and both prior and subsequent to their receipt of such compensation (R. 441-3). The record shows a two-year course of buying and selling by them, for their own accounts and others. *E.g.*:

(a) On May 7, 1957, Weinstein acquired options to purchase Masur's four shares and Treat's two shares, and personally advanced the option price. On June 14, 1957, he personally advanced the balance of the purchase price. Subsequently, he was reimbursed by Mrs. Blanche Waldman, in whose name the purchase was made on June 14th. Mrs. Waldman is Weinstein's sister; it was Weinstein who first advised her to buy the stock; and she relied on him com-

pletely to handle the transaction for her (R. 290-5). Those six shares were originally purchased from Malakoff as 3.0% of the total (200) shares; under the Court of Appeals' decision below, they are equal to 4.11%. Upon interrogation by the Debtor's attorney, Weinstein testified:

> "Q. Mr. Weinstein, you know that as president of the debtor that you are a fiduciary? A. I appreciate that.
>
> "Q. Mr. Weinstein, do you know as president of the debtor and that as a fiduciary you are not supposed to go out on the market and purchase stock of the debtor? A. Yes, sir.
>
> "Q. Yet you purchased this particular stock? A. Not for myself." (R. 295)

(b) On January 7, 1958, Laupheimer purchased one of D. H. Clark's three shares, and thereupon re-sold ⅔ of that one share to Weinstein for his own account (R. 303-4, 463). That one share was originally purchased from Malakoff as 0.33% of the total (200) shares; under the Court of Appeals' decision below, it is equal to 0.46%.

(c) A certain "Agreement of the Stockholders" of the Debtor, dated as of December 1, 1957, and effective for two years thereafter, was drafted by Weinstein and was executed (personally or by representatives) by 14 of the Debtor's 41 stockholders of record, including Weinstein, Laupheimer, and Fried (Saul General: Examiner's Exh. CA; 529, 963-8).

> "1. Each of the parties agrees that upon receipt of a bona fide offer to purchase all or any part of the stock held by them, which is intended to be accepted, and before entering into any contract for the sale thereof, he * * * must *first offer* the same for sale to the remaining parties hereto." (*Id.*, emphasis supplied).

On February 16, 1959, Weinstein asserted the applicability of the agreement to the stock of B. Clark and D. H. Clark.

On March 2 and 3, 1959, Weinstein and Fried purchased the remaining two shares of D. H. Clark's stock, B. Clark's four shares, and Karapontso's two shares. Those eight shares were originally purchased from Malakoff as 4.0% of the total (200) shares; under the decision below, they are equal to 5.48%. The entire transactions were handled by Weinstein, and the down-payments were advanced by Weinstein personally on March 2 and 3; the balance of the purchase price was advanced by Fried on April 10 and 14; and about April 22, Fried reimbursed Weinstein for his March advances. The March contracts of sale, drafted by Weinstein, stated that Weinstein was "acting on behalf of himself, Jerome Fried, H. Lawrence Laupheimer, and possibly probably others"; however, Weinstein later claimed that he had no beneficial interest in the purchase, and was acting as Fried's attorney in fact (470 2, Wolf's 25, R. 570, 10357).

(d) On December 24, 1957, Fried purchased Manoochehrian's twenty shares. On September 11, 1958, Fried re-sold ten of those twenty shares to Manoochehrian, retaining ten shares, reserving an option to re-purchase the other ten shares, and reserving the right to vote all twenty shares (R. 170, 176 7). Those twenty shares were disallowed by the Court of Appeals (R. 596).

3. *Race-track percentage rent reduction:* On August 18, 1952, the Debtor (as Lessor) and Joseph Sherman (as Lessee) entered into a purported ten-year "lease" to the Debtor's race-track, providing for Sherman to promote stock car racing (J. Fried Creditor; Margolis's Exh. C; R. 560, 7413; *See* R. 268). The race-track lease was executed for the Debtor by Fried as general manager. At the time of execution, and thereafter while Sherman was interested in the venture, Fried, Sherman and one Fehr were equal partners in the venture, pursuant to an oral agreement among them (R. 423-4).

On April, 28, 1953, without consideration, Sherman assigned the race-track lease to Nazareth Enterprises, Inc.

("Enterprises"), and Sherman and Fehr relinquished their interest in the race-track venture to Fried (R. 424-6; J. Fried Creditor: Examiner's Exh. 1; R. 556, 8333). Enterprises is a Pennsylvania corporation, of which Fried is president; all its outstanding stock is owned by Fried and his wife, equally. That condition has prevailed "throughout all the time involved here" (*i.e.*, since its incorporation on April 28, 1953) (R. 442). As Fried testified, "Nazareth Enterprises, Incorporated, was myself" (R. 6698). The District Court has ruled that Enterprises is Fried's *alter ego* (R. 272-3, 277).

The race-track lease fixes a percentage rent based on "gross admissions" collected by Enterprises at the box-office on racing days. The percentage rent varies between 12% and 15%, under the lease, depending upon whether the "Lessee" operates the food concession. There is no minimum guaranteed rent (J. Fried Creditor: Examiner's Exh. 1; R. 556, 8333).

Throughout 1953 and part of 1954 (*i.e.*, both before and after the Chapter X proceedings commenced), Enterprises paid rent to the Debtor computed at 12% of gross admissions. Then, sometime in 1954—*during* these proceedings—Weinstein and Fried reduced the percentage rent to 10% of gross admissions at "main events", *provided* Enterprises' aggregate "purses" (prizes paid to winning drivers) exceeded $1,500 per event; *i.e.*, the percentage rent would vary depending upon the amount of Fried's operating expenses.

They never wrote out their agreement. In theory, that agreement has remained expressly tentative from its inception: The percentage-rent reduction would remain in effect only so long as the Debtor profited from the deal; Weinstein—at any time, in his discretion—could restore the strict 12% or 15% rent under the written lease. The reduction has remained in effect continuously since first instituted in 1954. Weinstein and Fried never solicited a bid for the race-track lease from a race-track operator other than Fried (R. 401-4, 411-2, 467; 276-8).

On January 24, 1955—after the rent-reduction agreement—Rosen, as attorney for the Debtor, advised Enterprises (Fried) by letter that the Debtor "opposed" and "rejects" the race-track lease as "burdensome and oppressive" (J. Fried Creditor: Examiner's Exh. K; R. 557). The statute Rosen referred to was §116(1),[13] which authorizes rejection of "burdensome leases and other executory contracts at any time during the proceedings—but which vests authority in the judge, not the trustee (by contrast to ordinary bankruptcy). The Debtor never applied to the Chapter X court for such authority; later, the Debtor opposed Wolf's petition for rejection of the Enterprises lease (R. 273, 276-8).

On January 6, 1958, Enterprises (by Fried, as president) signed a new proposed race-track lease with the Debtor, which provided for a fixed percentage rent of 15% of gross admissions—irrespective of who operated the food concessions, and irrespective of Enterprises' gross "purses" (J. Fried Creditor: Debtor's Exh. AI, ¶3; R. 558, 8656). That lease was not to become effective until approved by the Court; however, the Debtor "agree[d] to apply for such approval without undue delay" (*Id.*, ¶4). No such application for approval has ever been submitted to the Court by Weinstein or Rosen in behalf of the Debtor.

The percentage-rent reduction was first disclosed to the District Court on April 6, 1959, in the course of cross-examination of Fried on his claims as a pre-Chapter X creditor and stockholder. Until then, the reduction had never been disclosed to the Debtor's directors other than Weinstein (R. 404, 270-1).

4. *Race-track food-concession-rent diversion:* From August 18, 1952, when Fried first began to operate the stock-car races at Nazareth (through his partner, Sherman, and then through his corporation, Enterprises), until the present,

[13] Bankruptcy Act, §116(1); 11 U. S. C. §516(1); 52 Stat. 885 (1938).

the food concessions both at the race-track and inside the Market proper have been operated exclusively by one James LaGrotte or by LaGrotte's corporation, J & J Foods, Inc.

Since 1952, LaGrotte and J & J have *always* had written concession agreements or leases with the Debtor with respect to the food concessions *inside the Market*. Three agreements were executed, on January 29, 1952, sometime in 1954 after J & J was organized, and on December 29, 1956. The 1952 and 1954 agreements fixed a percentage rent of 15% against a minimum; they did not specify locations, but they did exclude LaGrotte's operations at the race-track. The 1956 "lease" fixed a variable 15%-10% percentage rent against a minimum; that agreement was altogether silent as to race-track food sales (R. 412-7); Saul General Examiner's Exh. BC, R. 505, 7955; Wolf's 44; R. 571).

Since August of 1952—when LaGrotte began his food-concession operations *at the race-track*—LaGrotte and J & J have *never* had a written agreement with the Debtor or with Fried or Enterprises with respect to the race-track food concession. The oral race-track food-concession agreements between Fried and LaGrotte are understood by both Fried and LaGrotte to be terminable at will by either party. LaGrotte and J & J have always paid "rent" computed at 15% of the food-concession gross receipts (R. 412-7, 467, 477-8).

Throughout 1953 and part of 1954 (*i.e.*, both before and after these proceedings commenced), LaGrotte and J & J paid *all* percentage rents to the Debtor, computed on food sales *both* inside the Market and at the race-track. During that period, Enterprises (Fried) was paying percentage rents to the Debtor computed at 12% gross admissions. Then, sometime in 1954—*during* these proceedings—Fried instructed LaGrotte that J & J was thereafter to pay its rent (15% of its gross receipts) on the race-track food concession to Enterprises (Fried), no longer to the Debtor. LaGrotte complied. He never spoke with Weinstein about the change (R. 405-417, 467, 477-8; 278). LaGrotte testified:

"* * * In other words, when Jerry Fried told me to pay the Market the rent, I paid the Market. When he said to pay him, I paid him. Now what arrangements he made on that, I couldn't tell you." (R. 116)

The race-track food-concession rent diversion was first disclosed to the District Court on April 20, 1959, in the course of cross-examination of Fried on his claims as a pre-Chapter X creditor and stockholder (R. 108-121).

5. *Amount of race-track rent arrangements:* The unauthorized percentage-rent reduction has cost the Debtor at least $18,305.28 through 1960, and $23,996.77 through 1961—*assuming* the District Judge was correct in his ruling that the J & J rents "belonged" to Enterprises, that Enterprises owed only percentage-rent on its gross admissions, and that the race-track lease merely required Enterprises to pay 15% instead of 12% after Fried began collecting the J & J rents in 1957 (R. 276-8, 467-8). But if the Debtor—not Enterprises—"owned" the race-track food concession, then the unauthorized percentage-rent reduction was from 12% to 10% and 7%, and the food-concession rents all "belonged" to the Debtor; then the cost to the Debtor of the unauthorized reduction *and* diversion, is at least $33,706.83 through 1960. (See Appendix A, *infra*.)

6. The modification of the race-track lease by Weinstein and Fried is at least the fourth extraordinary transaction to which they have committed the Debtor during these proceedings without prior authorization by or disclosure to the District Judge. In 1957 and 1958, at their instance, the Debtor contracted to pave the Market's parking lot for over $15,000, the Debtor built an office building annex for Fried for over $6,000, and the Debtor borrowed $30,000 from a non-institutional lender at interest exceeding 6% and secured by an assignment of rents. The District Judge eventually ratified those transactions, after substantial modifications of the contracts (R. 248; *see* 280 F. 2d 891).

Summary of Argument

No. 27000

No. 27000 involves the allowance of claims to *stock interests* in the Debtor, a Pennsylvania corporation undergoing reorganization in the Southern District of New York. An overissue of stock (absolutely void under Pennsylvania law) precipitated this proceeding. The Chapter X court is adjudicating the ownership of a single class of the Debtor's stock, all issued and vested prior to the proceeding. The 36 competing stock-claimants are the real parties in interest; the Debtor is a nominal party. No plan of reorganization is pending, after more than nine years in court. The error below was the application of "federal" or "general" equity instead of applicable Pennsylvania and New York rules of decision to determine stock ownership.

1. *Rules of Decision:* In any federal civil action—a bankruptcy reorganization proceeding included—state law determines whether stock was validly issued by a corporation, and who among competing stock-claimants owns the validly issued stock.

> "§ 1652. The laws of the several states, except where the Constitution or treaties of the United States or Act of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply." [14]

The *Erie* [15] *principle* applies to *nondiversity* actions, too, by Congressional mandate (largely codifying this Court's prior case-law). No matter whether the nomenclature invoked is "law" or "equity," "rights" or "remedies," "substance" or "procedure" or "practice": the test is "outcome-

[14] Rules of Decision Act, 28 U. S. C. § 1652, 62 Stat. 944 (1948).
[15] *Erie R. Co.* v. *Tompkins*, 304 U. S. 64 (1938, *per* BRANDEIS, J.).

determinative." The exception—that no federal law or policy supervene in the case—does not apply here. The bankruptcy scheme of distributing assets of insolvent estates to creditors, is irrelevant. No other federal "substantive" law or policy impinges.

The Second Circuit Court of Appeals disregarded applicable state law, and substituted its own "federal" or "general" equity. The decision forfeited corporate stock for a putative lack of consideration to the issuer—disregarding the exclusive *remedy* under Pennsylvania corporation law. Then, "to do equity" (R. 591, 593), the decision impressed a purchase-money resulting trust—barred by both Pennsylvania and New York trust law. The overissue, *per se*, was not confronted. The decision would never have been made by a Pennsylvania or New York state court.

2. *Overissue Void:* Overissues of corporate stock are absolutely void under Pennsylvania law. That is what No. 27000 is all about—and bankruptcy has nothing to do with it.

Nazareth is authorized to issue a total of 200 shares of stock. Malakoff represented his ownership of a total of 200 shares. But he sold, and he caused Nazareth to issue, 262 shares to the 36 stock-claimants in No. 27000. All 36 have affirmed their stock-purchase contracts with Malakoff: all 36 want shares, not money, from the Debtor. Nazareth suffered no wrong: its net worth was not affected by the overissue, nor by the watering of the outstanding stock: no money judgment was entered against Nazareth. The *wrong* and the *loss* at issue, are Malakoff's independent *dilution* of all the stock-claimants' shares of stock, *i.e.*, his dilution of their proportionate interests in Nazareth net worth. The stock-claimants were injured *directly, not derivatively.* The controversy at bar involves the distribution of their loss *inter se*.

The excess 62 shares *must* be eliminated. The Pennsylvania corporation law on overissue would identify and void

the outstanding Nazareth shares in excess of 200, on some arithmetical or mechanistic or chronological basis. The holders of the void overissue would have no recourse against Malakoff: he had died in 1955, insolvent. Absolutely deprived of shares, they would have no recourse against Nazareth for damages on an estoppel or negligence theory; all 36 knew—had "notice" that—Malakoff (*qua* Nazareth agent) was self-dealing in Nazareth stock. But elimination of the overissued 62 shares would *not* resolve the ownership of the 200 authorized shares among the 36 stock-claimants.

An arithmetical or mechanistic or chronological basis of adjudicating ownership, seemed to the District Court arbitrary and inequitable, and was obviated by two general findings—undisturbed by the Court of Appeals—*viz.*: (a) *Identification* of the overissued shares was *impossible*. (b) *All* 36 stock-claimants were equally victims of Malakoff and *innocent* of participation in his wrongdoing, and lacked actual knowledge of his misconduct. Thereupon, the District Court allowed all 36 stock-claims. But instead of simply reducing the 262 outstanding shares *ratably* to the 200 authorized, the District Court substituted a "money invested" index of participation—its only error, Wolf submits.

Absent liability of any stock-claimant in tort, this proceeding is *not* a suit "by a receiver of an insolvent corporation to compel its *promoters* and their *confederates* to restore illicit gains."[18]

And absent a mechanistic or chronological basis for eliminating the overissue, the only way left to exclude any of the 36 stock-claimants, was to stand all 36 (as Malakoff's assignees) in Malakoff's shoes; then, to void *all* the outstanding Nazareth shares, in order to bring estoppel or good-faith-purchase principles of equity into play; finally, to subject

[18] *Cf. McCandless* v. *Furlaud*, 296 U. S. 140, *at* 149 (1935, *per* CARDOZO, *J.*) (*emphasis supplied*).

(derivatively) some—not all—shares or stock claims to defenses and equities available as against Malakoff. The assignees excluded would be those on "notice" of infirmities, and those whose "antecedent debts" were not "value" in "reliance."

This was the theory advocated by the Debtor and the Weinstein-Fried Group on trial and on appeal—the theory rejected by the District Court and adopted by the Court of Appeals. It required *inter alia* that all 262 outstanding Nazareth shares be voided for lack of consideration to the issuer (the only ground supposedly available), and that no "notice" be imputed to the prevailing stock claimants. If Malakoff individually were selling his own valid shares, antecedent debts would be "value." If Malakoff *qua* Nazareth agent were selling an original issue, the later "investors" would be on "notice" of infirmities. So the theory became a purchase-money resulting trust in the Market (assets), not in Nazareth shares. Now, Malakoff was to be the *prevailing stock-claimants'* agent or trustee in purchasing the Market, not Nazareth shares. Antecedent debts would neither support an estoppel or good-faith purchase, nor constitute advances toward the purchase price of the Market. "Notice," if not absent, would be ignored—an "equity" strange to the jurisprudence. By excluding the aggrieved stock-claimants on that theory, the overissue would vanish. The fundamental problem—the overissue—need never be faced.

3. *Lack of Consideration for Stock:* All 36 stock-claimants paid Malakoff, the seller—not Nazareth, the issuer—for their Nazareth shares. *Therefore*, both Courts below voided *all* shares for lack of consideration.

The Pennsylvania Business Corporation Law provides:

> "§ 610. Validity of Shares.—The fact that shares are issued in violation of, or without full compliance with, the provisions of this act, *shall not make the shares so issued invalid*, unless they are issued in

violation of Article XVI, Section seven, of the Constitution of this Commonwealth." [17]

The Pennsylvania Constitution provides:

> "[XVI] § 7. No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. * * * " [18]

But the *remedy* is *not* cancellation of stock:

> "* * * However, the Pennsylvania cases are agreed that this constitutional provision [Art. XVI, § 7], standing alone, does not cause the issuance of stock without prepayment to be void. Rather, it is necessary that the legislature shall *implement* the constitutionally stated policy by a statute declaring the nature and extent of any infirmity which attaches to the stock so issued, and *what may be done about it. [Pa. cases cited.]*." [19]

The Court below read the Pennsylvania Constitution *only* (R. 591, n. 2; 593, n. 4); and altogether disregarded the Pennsylvania case-law interpreting it, as well as the Pennsylvania statutes implementing it—a repudiation of the quintessence of *Erie*.

(a) *Remedy:* The Pennsylvania Business Corporation Law has "implemented" the Pennsylvania constitutional policy, in detail. The remedy for lack of consideration to the corporation for stock issued, is *assessment* or call—collectible like any other contract debt, and secured by a lien

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[17] Pa. Bus. Corp. L. § 610; 15 Purdon's Pa. Stats. Ann. § 2852-610; P. L. 364, Art. VI, § 610 (1933) (*emphasis supplied*).

[18] Pa. Const., Art. XVI, § 7.

[19] *Grafton* v. *Masteller*, 232 F. 2d 773, *at* 775 (3d Cir., 1956, *per* HASTIE, *J.*); *cert. den.* 352 U. S. 832 (1956) (*Pa. forum; diversity jurisdiction; emphasis supplied*).

on the shares themselves. Cancellation may be effected *only* after foreclosure of the corporate lien on the stock, and then *only* if public sale brings no purchase or if the corporation fails to collect a money judgment for the deficiency.[20] In effect, if a stock subscription is unpaid, a stockholder has a statutory right of *redemption*—an opportunity (valuable in a rising market, as here) to pay the balance owed on his subscription. Management, by a selective call and lawsuit (or appeal), cannot forfeit stock to the issuer (and indirectly to the other stockholders) for lack of *pre*payment. This is "substantive."

(b) *Burden of Proof:* Pennsylvania law imposes on the issuer the burden of proof—including the risk of persuasion—that a stock subscription is unpaid, and how much is owed. This is "substantive." A stock certificate in regular form and registered on the corporate books—as here—establishes the stockholder's case. The Nazareth stock is no-par: the directors fix the price of the shares and the value of property (other than money) taken in consideration of issuance. In *Nazareth*, no proof was made, and no decision was made, as to the subscription price of the shares, nor the value of the Market property received in consideration of the issuance of all the outstanding shares, nor the amounts unpaid on any specific subscriptions. On the contrary, Judge Moore wrote:

> "* * * * From these persons [disallowed] the Debtor did not receive and was not intended to receive anything of value, either from them or *from Malakoff*. These shares as a matter of Pennsylvania law could have had no validity as an original issue. * * *
>
> "Despite the cloud of illegality obscuring *any* stock issuance, the Debtor came into corporate being

[20] Pa. Bus. Corp. L. §§ 604, 605, 609; 15 Purdon's Pa. Stats. Ann. §§ 2852-604, 605, 609; P. L. 364, Art. VI, §§ 604, 605, 609 (1933).

> and did acquire a valuable property which it still holds. *The Market property is sufficient to support a valid stock issue* to those entitled thereto. The sellers (Philadelphia group) have been paid for that property *by Malakoff*. * * *" (R. 591-2; *emphasis supplied.*)

In other words, the Market was paid for by Malakoff, and is sufficient consideration under Pennsylvania law for the issuance of *new* stock for purposes of a plan of reorganization—but the Market is *not* sufficient consideration under Pennsylvania law for the issuance of *old* stock for purposes of the allowance of claims! No reason is given—and there is no reason—why the Market should not have been sufficient in *value* to support a valid stock issue—old or new—to *all* the stock-claimants.

(c) *Res judicata:* The Chapter X summary proceedings afforded the Debtor the same opportunity as a local action to obtain the relief prescribed by Pennsylvania law, *viz.*: assessment, prerequisite to forfeiture. The Debtor could—and did—sue all the stock-claimants (who had appeared generally) for the allegedly unpaid subscription price. The District Court denied the Debtor's claims therefor (R. 264). No appeal was taken from that portion of the judgment by anyone. No stock-claimant owes any amount on a stock subscription: so much is *res judicata*. Under Pennsylvania law, absent liability on a subscription, shares cannot be forfeited to the issuer-corporation. This is "substantive."

4. *Purchase-Money Resulting Trust:* Having cancelled *all* the outstanding Nazareth stock as void for lack of consideration (despite the Pennsylvania corporation law), the Court of Appeals impressed a purchase-money resulting trust. What began as a distribution of the *Debtor's stock* in a reorganization of the Debtor, finished as a distribution of *Malakoff's assets* without Malakoff. Judge Moore wrote:

> "* * * The sellers (Philadelphia group) have been paid for that [Market] property by Malakoff. Malakoff in turn obtained the money *for this purpose* from those who thought that they were to receive an interest in the Nazareth Market. Malakoff as the promoter must be regarded as a *trustee*, fiduciary, *agent*, promoter or syndicator (the terminology is unimportant—the facts create the rights) *for those who gave him their funds for investment in the project.* They should in equity receive that for which they paid." (R. 592-3; *emphasis supplied.*)

Disallowed were the stock-claims of "those who did not make any payment but who rely upon antecedent indebtedness of Malakoff and other transactions with him unrelated to the Nazareth venture as consideration." (R. 594)

The rules of decision in *equity* in both Pennsylvania and New York bar such a *remedy* as the trust impressed below. This is "substantive."

(a) In *New York*, the purchase-money resulting trust has been abolished altogether, by statute.[21]

(b) In *Pennsylvania*, resulting trusts have been severely curtailed, by statute and case-law. A purchase-money resulting trust could operate here in favor of an "investor" *only* if his advances had been made to Malakoff *before* Malakoff paid the purchase price of the realty to the Philadelphia Group. Malakoff is said to have paid the Philadelphia Group a total of $77,010.84, and to have received a total of $79,025 from "investors," all *before* February 15, 1952 (R. 589). Yet, "investments" aggregating $145,987.34—almost half advanced *after* that date—have been allowed (R. 594-5, 598). Under Pennsylvania law, those later "investors" *cannot* be *cestuis* of a purchase-money resulting trust.

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[21] N. Y. Real Prop. L. (L. 1909, c. 52), (49 McKinney's N. Y. Consol. L.) §§ 91, 94.

(c) Neither can those later "investors" be good-faith purchasers of interests in the Market *vis-à-vis* the true *cestuis.*[22] *Because* Malakoff is now said to have acted (as trustee or *agent*) for *all* the "investors" (not for himself or Nazareth or the sellers) *in their acquisitions* (R. 592-3), the later "investors" are conclusively charged with *notice*—Malakoff's knowledge is imputed to them—that Malakoff was selling them what the true *cestuis* alone owned. Under Pennsylvania law, the stock-claims of the later "investors" with "notice" are entitled to no better standing than the stock-claims which were disallowed because consideration was "antecedent indebtedness of Malakoff." (*See* R. 592, 594.)

(d) If the later "investors" were admitted to participation on a *constructive trust* theory—if Malakoff is supposed to be a trustee *ex malificio* instead of or in addition to a resulting trustee—then those stock-claimants, too, should be admitted whose claims were disallowed because they "rely upon antecedent indebtedness of Malakoff and *other transactions* with him unrelated to the Nazareth venture as consideration" (R. 594). Those "other transactions" likewise raised constructive trusts *vis-à-vis* Malakoff. The Court below has abandoned all semblance of *notice* and *tracing* with respect to the later "investors." Indeed, on a constructive trust theory, Malakoff's creditors and *cestuis at large* should be admitted to participation in the Market.

5. *"Clearly Erroneous" Rule:* Apart from the Rules of Decision Act, the principal federal law applicable to No. 27000 is procedural—Rule 52(a).[23] The foregoing discussion has assumed (*arguendo*) that the Court of Appeals' statement of facts was correct. However, its statement of facts was *not* correct. The major errors (among many) were: (a) *tracing* of the purchase price of the Market, thus

[22] 21 Purdon's Pa. Stats. Ann. § 601; P. L. 425, § 1 (1901).
[23] Rule 52(a), Fed. Rules of Civil Proc., *f.* 28 U. S. C. § 2072.

setting aside the District Court's finding of *no tracing;* and (b) *intention* of the prevailing stock-claimants to deal with Malakoff in a *fiduciary* capacity, thus setting aside the District Court's finding that *all* 36 stock-claimants intended to deal with Malakoff in his *individual* capacity as stockholder-seller. The appellate substitution of findings, of course, was essential to the impression of a purchase-money resulting trust. But the District Court's findings were not "clearly erroneous"; indeed, they were the only reasonable findings on the evidence. In substituting its own findings, the Court of Appeals has committed an egregious violation of Rule 52(a).

6. *The Facts and the "Equities":* The Court below undertook "to do equity" (R. 591). Irrespective of the applicable rules of decision, Wolf would not be aggrieved if the Court had achieved its avowed purpose. The complex facts and the simple equities can be crystallized by focusing on the stock-claims of Weinstein and Fried, the winning appellants in the Court of Appeals. (See R. 120-6, 154-8.)

Weinstein and Fried, like most of the 36 stock-claimants, received Nazareth stock certificates early in 1953, for 7 shares and 3 shares (respectively), issued in each name, dated February 2, 1953, and regular in form (*i.e.*, bearing the corporate seal, and signed by Malakoff, then president, and by Fried, then secretary-treasurer). Fully 18 months earlier, in September of 1951, they had made their stock-purchase contracts with Malakoff, and they had then paid Malakoff—not Nazareth—for their shares, supposedly 3.5% and 1.5% of the total 200 shares. Weinstein paid $7,000 by check to Malakoff. Fried paid $2,000 by "credit" for a "profit" owed him by Malakoff on some "other transactions * * * unrelated to the Nazareth venture" (R. 594); nevertheless, Fried's stock-claim was allowed below. Weinstein and Fried collected "dividends" from Malakoff—not from Nazareth—for more than 18 months, at 20% per year on their "invest-

ments," yielding returns of over 30% before Malakoff failed personally. Fried's stock-purchase contract with Malakoff was oral. The only written contract and "muniment of title" held by Weinstein (and most of the stock-claimants) for 18 months, was Malakoff's personal letter-receipt—drafted by Weinstein, as Malakoff's lawyer—which read:

> "* * * all of the authorized stock of The Nazareth Farmers and Auction Market Inc. [*sic*] which owns the Market has been issued to me. * * * In the course of my management of the Market, I may cause to be issued to you *n* shares of my present stockholdings. * * *" (R. 186-7)

If Weinstein were awarded 3.5% of the total Nazareth stock, he would receive precisely "that for which [he] paid" (R. 593)—as under an express trust or a constructive trust. If he were awarded more, he would receive an unearned windfall, at the expense of other stock-claimants. Yet, more is what he sought on appeal below; and the Court of Appeals awarded him 4.79%, increasing his "shares" of Nazareth by about 37% (apart from the "dividends" he collected from Malakoff). The peculiar trust impressed below is the sole "equitable" device which can penalize 6 stock-claimants, while enriching 30 others, for Malakoff's individual wrongdoing—of which all 36 have been found equally innocent.

7. *Ratable Distribution of Fungible "When-Issued" Shares, by Contract:* The applicable rule of decision here—and the "equitable" resolution of all stock-claims—is § 6 of the Uniform Sales Act, in force in Pennsylvania and New York during the two-year period of the stock-purchase transactions with Malakoff, and *applicable to the sale of "when-issued" stock.* The corporate overissue is no more significant than if Malakoff had purported to sell an aggregate of 262 shares of AT&T while he bought only 200.

"[§ 5] 3. Where the parties purport to effect a *present sale of future goods*, the agreement operates as a contract to sell the goods."

"[§ 6] 1. * * * If the parties intend to effect a present sale [of an undivided share of goods], the *buyer*, by force of the agreement, becomes an *owner in common* with the owner or owners of the remaining shares.

"2. In the case of fungible goods, there may be a sale of an undivided share of a specific mass, *though the seller purports to sell and the buyer to buy a definite number*, * * * of the goods in the mass, and though the number, * * * of the goods in the mass is undetermined. By such a sale the buyer becomes owner in common of such a share of the mass as the number, * * * bought bears to the number, * * * of the mass. * * *"[24]

The *tripartite commercial* relationship among Malakoff, Nazareth, and the 36 stock-claimants *in the sale of Nazareth stock*, governs. Imputed "notice" of Malakoff's wrongdoing, and antecedent debts as "value," are irrelevant. No money judgments are awarded against anyone. The stock-purchase contracts with Malakoff—all affirmed by the parties—determine their proportionate "shares" or "interests" *inter se*. No money or "investment" index is substituted; no new contracts are made by the courts. The loss caused by Malakoff's oversales, is absorbed equally and ratably by all 36 stock-claimants, in proportion to the outstanding shares of Nazareth stock in their hands. These rights are "vested" under Pennsylvania law. They cannot Constitutionally be divested.

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[24] N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) §§ 86(3), 87; 69 Purdon's Pa. Stats. Ann. §§ 61(3), 62, P. L. 543, §§ 5(3), 6 (1915) [*Repealed*]; Uniform Sales Act, §§ 5(3), 6 (*emphasis supplied*).

No. 26362

No. 26362 involves the *denial of compensation* to officers of a Chapter X Debtor in possession, and their *removal from office*, for misconduct *during* the reorganization proceedings, *viz.*: personal trading in the Debtor's stock, and diversions of the Debtor's rents to themselves. The questions presented are the interpretation of § 249 and § 221(4) of Chapter X, and the proper choice of law as to Chapter X fiduciary compensation and continued service.

1. *Statutes*: The relief sought by Wolf, derivatively in favor of the Debtor and against Weinstein and Fried, the Debtor's president and general manager (respectively), is mandated by two sections of Chapter X, enacted in 1938, *viz.*:

> "§ 249. * * * No compensation * * * shall be allowed to any * * * person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock. * * *." [25]

> "§ 221. The judge shall confirm a plan if satisfied that— * * *
>
> "(4) all payments made or promised by the debtor * * *, for services * * * in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are *reasonable* * * *; * * *." [26]

Section 249 means what it says. Section 221(4) means what this Court said it meant over 20 years ago, in the *Woods* case:

> "Under chap. X of the Chandler Act the bankruptcy court has plenary power to review all fees and

[25] Bankruptcy Act, § 249; 11 U. S. C. § 649; 52 Stat. 901 (1938).
[26] Bankruptcy Act, § 221(4); 11 U. S. C. § 621(4); 52 Stat. 897 (1938) (*emphasis supplied*).

expenses in connection with the reorganization from whatever source they may be payable. [Footnote, quoting § 221(4).] Reasonable compensation may be allowed. * * * Furthermore, *'reasonable compensation for services rendered' necessarily implies loyal and disinterested service* in *the interest of those for whom the claimant purported to act.* * * * It is no answer to say that fraud or unfairness were not shown to have resulted. * * * Where an actual conflict of interest exists, no more need be shown in this type of case to support a denial of compensation." [27]

Section 249 is an explicit Congressional mandate to deny compensation from the estate to any Chapter X "fiduciary" who buys or sells the Debtor's shares (or other securities) during the proceedings for his own account. Section 221(4), as interpreted by *Woods*, is a broader mandate to deny compensation to any Chapter X "fiduciary" for misconduct. The misconduct extends to conflicts of interest and breaches of trust including—but not limited to—trading in the Debtor's stock for the fiduciary's own account. *E.g.*, § 221(4) also applies to a fiduciary's trading for the account of another where he thereby acts for fewer than all of his principals or *cestuis*, and to the fiduciary's participation in diversions of estate assets.

Section 221(4) further governs all compensation paid out of the estate indirectly, *e.g.*, fees owed contractually by interested parties to their own representatives for services rendered in the proceedings, though the fees are not disbursed by the trustee.

> "Hence Congress instituted controls, controls which became more pervasive as § 77B was evolved into Chapter X. * * * And § 221(4) is written in per-

[27] *Woods v. City Nat. Bank & Tr. Co.*, 312 U. S. 262, *at* 267-8 (1941, per DOUGLAS, J.) (*emphasis supplied*).

vasive terms—it applies to 'all payments' for services * * *, whoever pays them. * * *"

"These practical considerations support the literal reading of § 221(4) that it is the bankruptcy court that has jurisdiction to pass on these fees. Its jurisdiction is therefore exclusive * * * *"[28]

2. *Rules of Decision*: Congress and this Court deliberately exact a rigorous *federal* standard of conduct of all fiduciaries in federal receivership proceedings.

(a) The federal standard in issue applies to *compensation* and continued service, not necessarily to restitution of diverted estate assets and business opportunities. The difference in result may appear in the same case.[29] The remedies are cumulative, not exclusive, and are not to be elected by the wrongdoers.

(b) The federal standard applies to *conflicts of interest, per se*, without necessarily involving proof of actual injury to any *cestui*.

(c) *Insider trading* in securities is peculiarly a problem of corporate reorganization, and has thus been dealt with specially and expressly by Congress, in § 249. No provision comparable to § 249 appears in the chapters of the Bankruptcy Act relating to liquidation of estates. By contrast, the federal statute prohibiting fiduciary purchase of estate *assets*, applies equally to bankruptcy liquidation and reorganization proceedings.[30]

Denying compensation to Chapter X fiduciaries for insider trading and other misconduct, is a device to assure "loyal and disinterested *service*." It is a means to the an-

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[28] *Leiman* v. *Guttman*, 336 U. S. 1, *at* 7-8, 9 (1949, *per* DOUGLAS, *J.*).

[29] *E.g., Crites, Inc.* v. *Prudential Ins. Co.*, 322 U. S. 422 (1944, *per* MURPHY, *J.*).

[30] 18 U. S. C. [Criminal Code] § 154; 62 Stat. 690 (1948).

nounced end and purpose of safeguarding assets in federal judicial custody and protecting interested parties from subtle insider looting difficult to prove in fact and not cured simply by more lawsuits for restitution and damages. The federal standard is simply stricter than the standard under "general equity," *because* reorganization is not the usual method of doing business. State standards applicable to private corporations outside receivership, and applicable to "persons who, despite their fiduciary obligations, had been free to buy or sell stock of the corporation before the Chapter X proceeding was contemplated" (R. 580), are a fiction, not a norm, in Chapter X proceedings.

3. *Format and Construction:* Before and throughout these reorganization proceedings, Weinstein has been president and a director of the Debtor, and Fried has been general manager. The District Court appointed no trustee, but continued the Debtor in possession under former management. Weinstein and Fried have been *de facto* co-trustees. The District Court found that both were "fiduciaries" under § 249 (R. 251). Fried questions that finding; the Court of Appeals did not reach the question.

If Weinstein and Fried had applied for compensation *in gross at the winding-up*, under § 247[32] (as do most other "fiduciaries"), then § 249 would apply and would bar all compensation to them. So much the Court of Appeals concedes. But Weinstein and Fried have been paid salaries *week-by-week during* the proceedings, under § 191.[33] Section 191 is located in Article VIII of Chapter X, while § 247 and § 249 are located in Article XIII. *Therefore*, said Judge Friendly:

> "* * * Not being required to seek compensation under § 247, they have not been subjected to § 249, and the

[32] Bankruptcy Act, § 247; 11 U. S. C. § 647; 52 Stat. 901 (1938).
[33] Bankruptcy Act, § 191; 11 U. S. C. § 591; 52 Stat. 893 (1938).

order of removal cannot survive the fall of its underpinning. [Footnote 5]" (R. 579)

And § 249 does not mean what it says, because its "context" must be restricted (R. 579). (Section 221 is in Article XI. The opinion below cites neither § 221 nor *Woods*.)

That construction of the format of Chapter X disregards (*inter alia*) an explicit statutory command:

"[5]b. Sections and subdivision headings shall not be taken to govern or limit the scope of the sections or subdivisions to which they relate." [34]

4. *Double Standard:* To bolster its statutory construction and application of § 249, the Court below posited a double standard which Congress had supposedly intended and implemented.

"* * * For these strangers [§ 247 applicants] the only road to compensation from the debtor's assets is interposition by the court—in sharp contrast to officers and employees of the debtor whose claim to compensation derives from *consensual arrangements*, subject only, in the case of officers, to judicial approval under § 191. * * *" (R. 580; *emphasis supplied.*)

"* * * Chapter X clearly distinguishes between *what is demanded* of a trustee and *what is expected* of officers of a debtor in possession. Section 156 requires that the trustee (other than the additional trustee * * *) must be *'disinterested,'* * * *. No such requirement was or practically could be imposed on officers of the debtor; * * *." (R. 580-1; *emphasis supplied*).

[34] Amendatory Act, § 5b; Additional Provisions of Act of June 22, 1938 (Chandler Act, c. 575, 52 Stat. 840 *et seq.*), § 5b; 11 U. S. C. § 1, notes.

That decision and reasoning would confound the announced federal policy, and would cloud a hitherto clear *caveat* to insiders.

Under Chapter X, *only* the trustee, the trustee's attorney, and the examiner are required to be "disinterested." It is not alone the officers and employees of a debtor in possession who need *not* be "disinterested." Likewise, virtually every other person serving in the proceedings, and looking to the estate for compensation, need *not* be "disinterested": *e.g.*, the "additional trustee," attorneys employed on specific retainers, indenture trustees, committee members. Except the trustee, the additional trustee, the trustee's attorney, and the examiner, all those persons are appointed by "consensual arrangements" with their clients.

(a) *Function and Power:* The Bankruptcy Act and the equity courts define the responsibilities of Chapter X fiduciaries by their functions, their powers, and their acts—not by their titles. Key operating personnel are "fiduciaries" subject to § 249 and § 221(4) *because* they have access to confidential information, and *because* they have actual control of the debtor being reorganized. Congress used the words "fiduciary" and "representative"—not "trustee"—in § 249 advisedly. Substance, not form, governs.

(b) "*Disinterested*": The word "disinterested" has two meanings—not one—in Chapter X proceedings. The requirement that a trustee (*e.g.*) be "disinterested" under § 156 and § 158[35] as a condition precedent to his *appointment*, relates to a *status* at *commencement* of the proceedings; his peculiar *duties* bar conflicts of interest with any of the interested parties, all of whom he serves equally. The requirement of § 221(4) and *Woods*—" 'reasonable compensation for services rendered' necessarily implies loyal and *disinterested service* in the interest of those for whom the claimant purported to act"—relates to *conduct during* the proceedings

[35] Bankruptcy Act, §§ 156, 158; 11 U. S. C. §§ 556, 558; 52 Stat. 888 (1938).

by any fiduciary, whether he serves one, several, or all. The privilege to serve without *being* "disinterested" under § 158, does *not* license the fiduciary to *act* other than "disinterestedly" under § 221(4) and *Woods*.

(c) *"Consensual Arrangements":* No matter whether the Chapter X court acts on its own motion or on the motion of a party: By statute (§ 221(4), § 249 and other sections) the court has plenary and exclusive control of *all* appointments and *all* compensation. Indeed, under § 221(4), the court *must* review the "reasonableness" of all compensation, irrespective of "consensual arrangements." Under the double standard posited below, "reasonableness" of compensation no longer "necessarily implies loyal and disinterested service." Absent application of the *substance* of § 221(4) (as stated in *Woods*), the exclusive jurisdiction of the Chapter X court over compensation (conferred by § 221[4]) would be hollow.

6. *Race-track rent diversions:* The Weinstein-Fried diversions of race-track rents from the Debtor to Fried *during* the proceedings, were recited in Wolf's petitions as alternative grounds for denial of compensation and removal from office (R. 217-224, 255). Both Courts below made their respective decisions in No. 26362 on the stock-trading and § 249 alone. Yet, Judge Friendly wrote:

> "* * * Nothing we have said is to be construed as concluding that Weinstein and Fried did breach fiduciary obligations in the transactions of which appellees [Wolf] complain; * * *." (R. 582)

The implicit condonation of the rent diversions, without findings or conclusions by either Court below, should not stand. If the stock-trading does not suffice for the relief sought by Wolf, then the race-track rent diversions must be decided under § 221(4).

7. *Restitution of Past Compensation:* The denial of compensation under § 249 and § 221(4), applies to fiduciary

service throughout the Chapter X proceedings. The entire expectancy is defeated if the fiduciary applies for compensation in gross at the winding-up. The same result should obtain here. To obey the statute, and to achieve the end contemplated, Weinstein and Fried should restore to the estate the salaries they have heretofore received during the Chapter X proceedings.

8. *Removal from Office:* Statutory denial of compensation was intended to assure "loyal and disinterested *service*" by fiduciaries *during* the proceedings. To achieve that end, Weinstein and Fried should be removed from office, and barred from further service during these proceedings, as the Debtor's managers. The *propriety* follows from § 249, § 221(4), and *Woods*.

The District Court's conclusion that the Chapter X court lacks *power* to *formally* remove officers of a Debtor in possession, is erroneous. (The Court of Appeals never reached the question.) Chapter X gives the judge plenary control of the Debtor; and it vests the judge with the powers of an equity receivership court. The Pennsylvania Business Corporation Law expressly vests local courts of equity with power of removal for cause. To continue the Debtor in possession as a *quasi*-trustee, provision must be made for removal from office for cause, no less than for election to office.

* * *

In No. 27000, the Court below applied federal rules of decision to a state question—the allowance of claims to stock interests which had vested under state law prior to reorganization. In No. 26362, the Court below applied state rules of decision to a federal question—the administration during reorganization of an estate in the custody of a federal court. In both cases, the Court below opted, in effect, to apply *No Law*, and instead to exercise naked power based on subjective notions of "general equity."

No. 27000

State law, not federal law, should determine the allowance of claims to stock interests in the Debtor in bankruptcy reorganization. Under applicable state law, all 36 stock-claims here should be allowed in direct proportion to the 262 outstanding shares of stock of record, notwithstanding the overissue.

The principal questions before the Court in No. 27000 are the proper choice of law as to the allowance and disallowance of claims to stock interests in a debtor in reorganization under Chapter X of the Bankruptcy Act, and the interpretation of the Rules of Decision Act [36] in a nondiversity case.

The applicability of state rules of decision in bankruptcy reorganization proceedings and other federal *nondiversity* cases, presents a question of federal law which has been noted by this Court repeatedly since *Erie* [37] in 1938, but which has not yet been settled. Further, if state rules of decision are applicable, the questions are presented, Whether the application of such state rules of decision extends to cases in equity as well as at law, and to remedies as well as rights—questions likewise noted but unsettled.[38] Still another question which this Court has expressly left unsettled at least four times [39]

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[36] Rules of Decision Act, 28 U. S. C. § 1652, 62 Stat. 944 (1948).

[37] *Erie R. Co.* v. *Tompkins*, 304 U. S. 64 (1938, *per* BRANDEIS, J.).

[38] *See Russell* v. *Todd*, 309 U. S. 280, *at* 294 (1940, *per* STONE, J.) (*nondiversity*); *Guaranty Trust Co.* v. *York*, 326 U. S. 99, *at* 99-101 (1945, *per* FRANKFURTER, J.) (*diversity*); *Holmberg* v. *Armbrecht*, 327 U. S. 393 (1946, *per* FRANKFURTER, J.) (*nondiversity*); *Textile Workers Union* v. *Lincoln Mills*, 353 U. S. 448 (1957, *per* BLACK, J.) (*W. B.* 353 U. S. *at* 474, 482-3, *per* FRANKFURTER, J., *dissenting*) (*nondiversity*).

[39] *D'Oench, Duhme & Co.* v. *F. D. I. C.*, 315 U. S. 447, *at* 456 (1942, *per* DOUGLAS, J.; FRANKFURTER, JACKSON, JJ., *concurring*); *McKenzie* v. *Irving Trust Co.*, 323 U. S. 365, *at* 371, n. 2 (1945, *per* STONE, C. J.); *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156, *at* 162 (1946, *per* BLACK, J.; FRANKFURTER, J., *concurring*); *Richards* v. *U. S.*, 369 U. S. 1, *at* 7, n. 13 (1962, *per* WARREN, C. J.).

since *Erie*, may be presented here, *viz.*: the choice of conflicting state laws by a federal court in a nondiversity case; *i.e.*, here, if state law applies with respect to corporations and trusts, must the bankruptcy court adopt the choice-of-law rules of the forum state (New York)? If not, must the bankruptcy court adopt the "whole law" or only the "internal law" of the state to which it looks for decision (New York or Pennsylvania)?

Both Courts below ignored the applicable state law, and the question of its applicability. Their decisions represent their respective conceptions of "general" or "federal" equity, and differ markedly from both New York and Pennsylvania rules of decision.

As to the substantive issues underlying the choice-of-law questions:

No court can fully satisfy all 36 stock-claims interposed in No. 27000. There is not enough Nazareth stock. Each share outstanding purports to be $\frac{1}{200}$ of the total, under the Nazareth articles of incorporation; and so Malakoff promised and represented to his customers. But Malakoff sold at least 262 shares to the 36 stock-claimants in No. 27000; he caused an overissue of at least 62 shares by Nazareth. What Nazareth received for all 262 shares, was the Market (realty and business). The Debtor and the Weinstein-Fried Group contend that the Market was not sufficient consideration for the authorized 200 shares—indeed, that the Market was consideration for no shares at all.

Whether by overissuance or by issuance without consideration (or both), Malakoff did commit a wrong and impose a loss. In the first instance, that loss did not fall on the corporation or its stockholders *derivatively*. What Malakoff did, was to over-divide and *dilute* the proportionate interests of the 36 stock-claimants in the Market and the Nazareth corporation. In the first instance, the wrong and the loss

were suffered by all the stockholders *directly* in proportion to their stockholdings of record—all 36 of them alike victims and innocent of wrongdoing. The major substantive question is how to distribute that loss among the 36 stock-claimants.

A most elementary proposition underlies Wolf's position in No. 27000: A corporation, after all, is simply an association of persons who have elected—by contract—to use a particular legal form or device—the corporation—to hold property and to conduct a business together. At least to the extent that their express contracts do not resolve controversies among themselves, they are subject to the law of corporations of the appropriate jurisdiction to resolve their controversies for them. The stockholders cannot at once adopt and repudiate the corporate form; they cannot pick and choose among corporate and non-corporate laws. The joint-venture form does not apply—

> "... a joint venture may not be carried on by individuals *through* a corporate form. [Cases cited.] The two forms of business are mutually exclusive, each governed by a separate body of law. When parties adopt the corporate form, with the corporate shield extended over them to protect them against personal liability, they cease to be partners and have only the rights, duties and obligations of stockholders. They cannot be partners *inter sese* and a corporation to the rest of the world.' [Citation.]" [40]

—nor do other non-corporate forms of doing business and holding property apply, *e.g.*, the resulting trust.[41] Before the chancellor invokes a supervening "equity" to determine the rights of competing stock-claimants, he owes respect to

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[40] *Weisman* v. *Azenair Corp.*, 3 N. Y. 2d 444, *at* 449, 165 N. Y. S. 2d 745 (1957, *per* CONWAY, C. J.) (*emphasis in original*).

[41] *See Musselman* v. *Myers*, 240 Pa. 5, 87 A. 425 (1913, *p.c.*).

the corporate law and policy of the appropriate jurisdiction, especially in our federal system. The rules of decision of Pennsylvania and New York already embody an "equity" deliberate, ample, and harmonious.

The substantive relief sought here by Wolf, as against the Debtor (nominally) and all other stockholders in interest, is the allowance of all 36 stock-claims involved in No. 27000, in such amounts that the Debtor's 200 authorized shares will be distributed among those 36 stockholders of record, in direct proportion to their respective record holdings of the 262 shares actually issued to them in 1953. There would be no judgment for money damages against the Debtor, and no judgment for assessment of stock subscription prices against the stockholders. The massive record compiled by the District Court in these proceedings, and the District Court's findings and conclusions, suffice for—and compel—such final decision here.[42]

[42] No. 27000 involves 36 stock-claimants and 262 shares of record. It does not involve the five stock-claimants in the "Margolis Group," whose claims to 54 shares were tried separately by Referee Joyce, were never tried or decided by Judge Sugarman on review, and were decided by the Court of Appeals, in No. 26962, at the same time as No. 27000, but without joinder of the 36 stock-claimants (including Wolf) involved in No. 27000. In an abundance of caution, Wolf has named and saved the Margolis Group as respondents on this appeal from No. 27000. Nevertheless, Wolf seeks no relief with respect to the Margolis Group's 54 shares. Wolf submits that no decision of the Margolis Group stock-claims is proper in the absence of the record in No. 26862, and that this Court's award of the relief prayed for by Wolf in No. 27000 would require a reservation and remand to the District Court to determine whether and to what extent the Margolis Group were entitled to participate in the 200 authorized shares with the 36 stock-claimants in No. 27000. Such reservation for adjustment had been provided for by the District Court (R. 264, 212), but was superseded by the Court of Appeals (R. 597).

A. Under federal statutes, rules, orders, and decisions of this Court, state—not federal—rules of decision are applicable and determinative in the allowance of claims to stock interests in the Debtor undergoing bankruptcy reorganization.

No. 27000 is a nondiversity case, with federal question jurisdiction "arising under" the Constitutional bankruptcy clause and resting on Chapter X of the Bankruptcy Act. It is mere *form*, and the fortuity of one party's insolvency, that all parties plead by proofs of claim and objections, that they litigate in summary proceedings in bankruptcy, that the federal court decrees allowance or disallowance of claims. The substance is federal adjudication of rights and liabilities. Wolf submits that the *Erie* interpretation and application of the Rules of Decision Act in diversity cases—the *Erie principle*—extends to nondiversity cases as well, this case included.

The threshold question is always the choice of law. The peculiar problem of the federal forum, irrespective of its source of jurisdiction, is whether to resolve a controversy between *private* litigants any differently from the resolution the federal court must *hypothesize* as emanating from a state court in an identical case. The decision below, based on "general equity," conflicts with the rules of decision of both Pennsylvania and New York, the two states having "contact" with the transactions involved. Wolf submits that a state court (or a federal diversity court), sitting in either state, would never have made the decision made by the Second Circuit Court of Appeals in No. 27000, and that, *therefore*, the decision below should be reversed.

1. *The Rules of Decision Act and the* Erie *principle apply to nondiversity cases, bankruptcy proceedings included, and extend to both rights and remedies, in equity as well as at law.*

(a) The Rules of Decision Act expressly applies to all "civil actions," not alone to "trials at common law." The

applicability of state rules of decision does *not* depend on whether a cause of action or a defense sounds "at law" or "in equity."

> "§ 1652. *State laws as rules of decision.*
>
> "The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in *civil actions* in the courts of the United States, in cases where they apply." [43]

The Reviser's Note to § 1652 states:

> "'Civil actions' was substituted for 'trials at common law' to clarify the meaning of the Rules of Decision Act in the light of the Federal Rules of Civil Procedure. Such Act has been held to apply to suits in equity."

The Reviser's Note (*id.*) refers to the *Mason* case:

> "It was urged upon the argument that § 721 * * *, which provides that the laws of the several states shall be regarded as rules of decision in trials *at common law* in the courts of the United States, by implication, excludes such laws as rules of decision in equity suits. The statute, however, is merely declarative of the rule which would exist in the absence of the statute. * * *" [44]

The relevant Federal Rules of Civil Procedure (referred to in the Reviser's Note to § 1652) are Rules 1 and 2: [45]

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[43] Rules of Decision Act, 28 U. S. C. § 1652, 62 Stat. 944 (1948), amending Judiciary Act of 1789, § 34; 1 Stat. 92, Rev. Stat. § 721, 28 U. S. C. (1940 ed.) § 725.

[44] *Mason* v. *U. S.*, 260 U. S. 545, *at* 558-9 (1923, *per* SUTHERLAND, J.; *emphasis in original*).

[45] Rules 1, 2, Fed. Rules of Civ. Proc., *post*, 28 U. S. C. § 2072.

"Rule 1. *Scope of Rules.* These rules govern the procedure in the United States district courts in all suits *of a civil nature* whether cognizable as cases at law or in equity, with the exceptions stated in Rule 81. * * *"

"Rule 2. *One Form of Action.* There shall be one form of action to be known as 'civil action'."

The *Erie* case was a diversity tort action at law. The *Erie* principle was soon—and steadfastly—applied to diversity suits in equity, of all types.[46]

(b) The applicable state rules of decision extend to *remedies* and *defenses* as well as rights, in equity as well as at law. A right without a remedy is no right. Conversely, there is no remedy except as founded on a substantial and *cognizable* right.[47] The restrictions of the remedy are definitive of the right, and, if statg-created, govern a federal court's adjudication no less than a state court's. Once federal jurisdiction attaches, whether diversity or nondiversity, the federal court can—and should—adapt its processes to afford or approximate the remedy prescribed by the applicable state law. But if state law would withhold a remedy, so, too, should a federal court applying that state law. "It seems to us unjust to allow a plaintiff to come here absolutely depending on the foreign law for the foundation of his case, and yet to deny to the defendant the benefit of whatever limitations on his liability that law would impose."[48] The "outcome-determinative" index of *York* governs what survives of the "equitable remedial rights doc-

[46] *Ruhlin* v. *N. Y. Life Ins. Co.*, 304 U. S. 202 (1938, *per* REED, *J.*); *Guaranty Trust Co.* v. *York*, 326 U. S. 99 (1945, *per* FRANKFURTER, *J.*).

[47] *Kelleam* v. *Maryland Cas. Co.*, 312 U. S. 377 (1941, *per* DOUGLAS, *J.*).

[48] *Slater* v. *Mexican Nat. R. Co.*, 194 U. S. 120, *at* 126 (1904, *per* HOLMES, *J.*).

trine." Practice alone remains federal in federal application of state law.[49]

These same principles obtain in nondiversity cases, and were applied by this Court even before *Erie*.[50]

(c) Litigations in bankruptcy proceedings—one species of cases in federal courts having nondiversity jurisdiction—are "civil actions" within the comprehension of the Rules of Decision Act.

> "Rule 81. *Applicability in General.*
>
> "(a) * * * (1) These rules * * * do not apply to proceedings in bankruptcy * * *, except in so far as they may be made applicable thereto by rules promulgated by the Supreme Court of the United States. * * *"[51]

The Federal Rules of Civil Procedure have generally been made applicable to bankruptcy proceedings by rules—General Orders—promulgated by this Court, and having the force of law.[52]

> "37.—*General Provisions.* In proceedings under the [Bankruptcy] Act the Rules of Civil Procedure for the United States District Court shall, in so far as they are not inconsistent with the Act or with these general orders, be followed as nearly as may be. * * *"

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[49] *See Levinson* v. *Deupree*, 345 U. S. 648 (1953), *per* FRANKFURTER, J.); 2 *Moore's Fed. Prac.* (2 ed., 1961) ¶ 2.09.

[50] *Mason* v. *U. S.*, *supra*, n. 44, 260 U. S. *at* 559-560; *see Bank of Hamilton* v. *Lessee of Dudley*, 2 Pet. (27 U. S.) 492, *at* 526 (1829, *per* MARSHALL, C. J.); *Mfrs. Fin. Co.* v. *McKey*, 294 U. S. 442 (1935, *per* SUTHERLAND, J.).

[51] Rule 81 (a) (1), Fed. Rules of Civ. Proc., *f.* 28 U. S. C. § 2072.

[52] General Order 37, General Orders and Forms in Bankruptcy, *pursuant to and f.* Bankruptcy Act, § 30, 11 U. S. C. § 53, 30 Stat. 554 (1898), 52 Stat. 855 (1938); 305 U. S. 681 (1939). G. O. 37 applies to proceedings under Chapter X. G. O. 52 (1), (2). *See Orcutt* v. *Green*, 204 U. S. 96 (1907, *per* PECKHAM, J.).

The Chapter X court is expressly vested with the powers of an equity receivership court, in addition to the statutory powers more narrowly relating to administration of the Act. Its jurisdiction and powers are sufficiently broad to approximate the relief available to a private party litigant in a state court of law or equity.[53]

(d) Apart from federal statutes and rules—*i.e.*, even if there were no Rules of Decision Act on the books—the *principle* of *Erie*, irrespective of jurisdictional grounds, requires that the plaintiff's asserted right to relief be founded on some positive political *authority*, state or federal. The federal courts have Constitutional limitations, not only as to cases they may entertain, but as to rights they may enforce and as to defenses they may sustain in cases where jurisdiction has already attached validly. This is not just a matter of Congressional *intent* as expressed in the Rules of Decision Act. This is a matter of Congressional and judicial *power* under the Constitution.

Erie determined the rules of decision in federal *diversity* cases. Narrowly, *Erie* held that the accident of diverse state citizenship between the parties should not bring a result in federal litigation different from the result in an identical litigation in a state court between citizens of the same state; that the federal courts should not be misused, through diversity jurisdiction, for forum-shopping to obtain different results irrelevant to the Constitutional purpose of impartial trial. More broadly, *Erie* also held that judge-made law is state law, too; that Justice Story's desideratum of national uniformity of then-uncodified law-merchant through intercession of the federal courts, had failed of achievement in practice; that the desideratum must yield to a policy of uniformity of state law, in order that federal and state courts sitting within a single state should not pronounce and apply

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[53] Bankruptcy Act, § 115; 11 U. S. C. § 515; 52 Stat. 884 (1938). *See* Hill, *Erie Doctrine in Bankruptcy*, 66 Harv. L. Rev. 1013 (1953); 4 *Collier on Bankruptcy* (14th ed.) ¶¶ 70.04, 70.15[2], 70.25[2], 70.49, 70.70[2], 70.78.

different rules of decision in identical cases. Still broader was the explicit foundation of *Erie*—which has equal application to both diversity and nondiversity cases:

> "*Third.* Except in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the state. And whether the law of the state shall be declared by its Legislature in a statute or by its highest court in a decision is not a matter of federal concern. There is no federal general common law. Congress has no power to declare substantive rules of common law applicable in a state whether they be local in their nature or 'general,' be they commercial law or a part of the law of torts. And no clause in the Constitution purports to confer such a power upon the federal courts. * * * *"*
>
> "The fallacy underlying the rule declared in Swift v. Tyson is made clear by Mr. Justice Holmes. [Footnote citations.] * * *
>
> "'But law in the sense in which courts speak of it today does not exist without some definite authority behind it.' * * *
>
> "'The authority and only authority is the State, and if that be so, the voice adopted by the State as its own [whether it be of its Legislature or of its Supreme Court] should utter the last word.'
>
> "Thus the doctrine of Swift v. Tyson is, as Mr. Justice Holmes said, 'an unconstitutional assumption of powers by the Courts of the United States which no lapse of time or respectable array of opinion should make us hesitate to correct.' * * * *"* [54]

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[54] *Erie R. Co. v. Tompkins*, 304 U. S. 64, *at* 78-9 (1938, *per* BRANDEIS, J.), *citing and quoting* HOLMES, J., *dissenting*, *Kuhn v. Fairmont Coal Co.*, 215 U. S. 349, *at* 370-2 (1910); *Black & White Taxicab Co. v. Brown & Yellow Taxicab Co.*, 276 U. S. 518, *at* 532-6 (1928).

That foundation has been explained repeatedly since *Erie*, and has been applied and adapted in equity cases involving remedies and defenses, *e.g.*, in *York*:

> "Our starting point must be the *policy of federal jurisdiction* which [*Erie*] embodies. In overruling Swift v. Tyson, 16 Pet. 1; [*Erie*] did not merely overrule a venerable case. It overruled a *particular way of looking at law* which dominated the judicial process long after its inadequacies had been laid bare. [Citations.] Law was conceived as a 'brooding omnipresence' of Reason, of which decisions were merely evidence and not themselves the controlling formulations. Accordingly, federal courts deemed themselves free to ascertain what Reason, and therefore Law, required wholly independent of authoritatively declared State law, even in cases where a legal right as the basis for relief was created by State authority and could not be created by federal authority and the case got into a federal court merely because it was 'between Citizens of different States' under Art. III, § 2 of the Constitution of the United States."
>
> "• • • In essence, the intent of that decision was to insure that, in all cases where a federal court is exercising jurisdiction solely because of the diversity of citizenship of the parties, the *outcome of the litigation* in the federal court should be substantially the same, so far as legal rules determine the outcome of a litigation, as it would be if tried in a State court. • • • "[55]

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[55] *Guaranty Trust Co.* v. *York*, 326 U. S. 99, *at* 101-2, 109 (1945, *per* FRANKFURTER, *J.*) (*emphasis supplied*).

2. *This case involves the validity of stock in the Debtor, and the ownership of stock by the stock-claimants. Notwithstanding the form of adjudication by allowance of claims in bankruptcy reorganization proceedings, the substantive rights of the parties are determined by state law.*

(a) The Court below erroneously viewed the "basic issue" or "problem" in No. 27000 as the formulation of a plan of reorganization, not as the allowance of claims to stock interests:

> "* * * To achieve a reorganization of the Debtor which, insofar as stock issuance and ownership are concerned, never had been properly organized, the trial court had to determine as a *basic issue*: who, if any, were entitled to participate in the stock of the reorganized Debtor. * * *" (R. 590; *emphasis supplied.*)

> "Since the *problem* for the reorganization court is to decide upon the capitalization necessary to do *equity* in the light of the various claims before it, this court need pass *only* upon the immediate *question* of *who should be stockholders of the reorganized debtor* and in what proportions. With these basic principles determined, the solution becomes more clearly defined. * * *" (R. 591; *emphasis supplied.*)

The Chapter X court cannot reach the question, Who *shall be* the stockholders of the reorganized debtor at the close of the proceedings?, until it first decides the question, Who *were* the stockholders of the Debtor at the commencement of the proceedings? Every reorganization involves at least two distinct steps, or stages: *first* determination of its creditors and stockholders, by the *allowance of claims;* and *thereafter*, provision for participation of those creditors and stockholders in the debtor's assets, by formulation of a *plan of reorganization.*[56] The first stage—the allowance of claims—is the only stage this proceeding has reached. No plan of

[56] *See* 6 *Collier on Bankruptcy* ¶ 9.02[1].

reorganization submitted by anyone is even pending before any court in these proceedings; and no issuance of stock in a "reorganized" debtor is properly before the courts.

(b) The allowance of claims of creditors and stockholders in bankruptcy proceedings is normally governed by state law.

> "A purpose of bankruptcy is so to administer an estate as to bring about a ratable distribution of assets among the bankrupt's creditors. What claims of creditors are valid and subsisting obligations against the bankrupt at the time of petition in bankruptcy is filed is a question which, in the absence of overruling federal law, is to be determined by reference to state law. * * * "
>
> "* * * We do not reach considerations of policy in bankruptcy administration until there are rights created by applicable local law, to be recognized." [57]

(c) There is no "overruling federal law" or supervening bankruptcy policy applicable in No. 27000: No substantive or positive provision of the Bankruptcy Act or any other federal statute has been invoked or would be applicable here; the rights were not federally created, and this case is no occasion to "legislate interstitially" or to "fashion federal law" as to rights or remedies.[58] The bankruptcy scheme of distribution is irrelevant to a distribution among a single class of stockholders.[59] No federal agency is a party.[60]

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[57] *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156 (1946), *at* 161 (*per* BLACK, J.); *at* 171 (FRANKFURTER, J., *concurring*).

[58] *Cf. McKenzie* v. *Irving Trust Co.*, 323 U. S. 365 (1945, *per* STONE, C. J.); *Holmberg* v. *Armbrecht*, 327 U. S. 393 (1946, *per* FRANKFURTER, J.); *Schwabacher* v. *U. S.*, 334 U. S. 182 (1948, *per* JACKSON, J.).

[59] *See Prudence Realization Corp.* v. *Geist*, 316 U. S. 89 (1942, *per* STONE, C. J.).

[60] *See Bank of America Nat. Tr. & Sav. Assn.* v. *Parnell*, 352 U. S. 29 (1956, *per* FRANKFURTER, J.); *D'Oench, Duhme & Co.* v. *F. D. I. C.*, 315 U. S. 447 (1942, *per* DOUGLAS, J.).

This is *not* a suit "by a receiver of an insolvent corporation to compel its *promoters* and their *confederates* to restore illicit gains."[61] Malakoff was the "sole actor," and is not a party. No "inequitable *conduct*" or fraud by *any* of the stock-claimants has been found by the Court of Appeals or the District Court—nor is that the basis for the disallowances below.[62]

(d) The "substantive" rights and defenses involved in No. 27000 were all created by state law.

(i) The controversies between the Debtor and each of the 36 stock-claimants, involve the *validity of corporate stock* challenged on grounds of overissue and lack of consideration for issuance, and the liability of each stock-claimant to the Debtor for an allegedly *unpaid stock subscription*. The Debtor, by its counterclaims, effectually instituted suit as plaintiff to collect those contractual subscriptions for a solvent corporation, and indirectly for its stockholders—*not* to assess its stockholders for contributions to a trust fund for creditors of an insolvent corporation. In voiding and forfeiting corporate stock, the Court below failed to sustain certain defenses asserted by Wolf and created by state (domiciliary) corporation law. No federal law impinges.

(ii) The controversy among the stock-claimants *inter se* involves their proportionate ownership of corporate stock, however many shares were validly issued. Here, the 36 stock-claimants are all plaintiffs (so to speak) competing for allowances in a limited pool of corporate stock; the Debtor is a nominal party. Wolf submits that the commercial *law* of sales resolves that controversy, without recourse to "equity." The Court below, by voiding all outstanding Nazareth stock, treated the Debtor as a corpora-

[61] *Cf. McCandless* v. *Furland*, 296 U. S. 140, *at* 149 (1935, *per* CARDOZO, *J.*) (*emphasis supplied*).

[62] *Cf. Taylor* v. *Standard Gas & Electric Co.* ["*Deep Rock*"], 306 U. S. 307 (1939, *per* ROBERTS, *J.*); *Pepper* v. *Litton*, 308 U. S. 295 (1939, *per* DOUGLAS, *J.*).

tion without stockholders; then, turning from law to equity, the Court below treated the Debtor as a passive or dry trustee holding title to the Debtor's *assets* (the Market) for the benefit of *some* of the 36 stock-claimants *qua cestuis*. The Court of Appeals' decree is a judicial conveyance of Pennsylvania realty, as if these proceedings were a quiet-title action. Its decree is incompatible with the rules of decision in equity in both Pennsylvania and New York as to the relative equities of competing purchasers or *cestuis*. Its decree grants an *affirmative* "equitable remedy" under a "federal general common law" or "federal general equity." No positive federal law gives any party a right in support of that remedy. No federal law or policy even impinges. Applicable state rules of decision bar that remedy.

3. *In this case, no material conflict of laws should be encountered in applying state rules of decision. If conflict should appear, the federal court with nondiversity jurisdiction should use a "grouping of significant contacts" or "center of gravity" rule to choose applicable state rules of decision, and should apply the "whole law" so chosen.*

The only two states with any "contact" with the transactions in issue, are Pennsylvania and New York. Provided the "whole law"—not merely the "internal law"—is applied, no conflict of laws should be encountered. For both states have approached a uniformity of commercial law through the enactment of uniform statutes and by the adoption of similar conflict-of-laws rules.

(a) The "whole law" of the corporation's domicile—here, Pennsylvania—governs the validity of stock, the ownership of stock by stockholders, and the liability of stockholders to assessment or call on a stock subscription or otherwise.[63] The domiciliary state's control of its corporate creatures is as much its own interest as is the situs state's control of

[63] *Harrigan* v. *Bergdoll*, 270 U. S. 560 (1926, *per* BRANDEIS, *J.*), *affg.* 281 Pa. 186, 126 A. 269 (1926, *per* FRAZER, *J.*). *See* 12A Purdon's Pa. Stats. Ann. [Uniform Commercial Code] § 8-106; P. L. 3 (1953), *added* P. L. 1023 (1959) § 8.

realty within its borders. This Court's recognition of that interest has dictated that other states apply domiciliary law, within the full-faith-and-credit provision, in adjudicating the relationships between the corporation and its stockholders.

> "* * * The assessment is an incident of the incorporation. Thus the subject matter is peculiarly within the regulatory power of New York, as the State of incorporation. 'So much so,' [citation] 'that no other State properly can be said to have any public policy thereon. * * * For 'the act of becoming a member [of a corporation] is something more than a contract, it is entering into a complex and abiding relation, and as marriage looks to domicil, membership looks to and must be governed by the law of the State granting the incorporation.'" [Citation.] * * * "[64]

(b) The rights of competing stock-claimants to ownership of valid stock, depend on personal relationships and transactions to which the corporation and the domiciliary state may be indifferent. A judgment affecting the relative rights of two parties to an *in personam* action in (say) New York, and relating to title to land or chattels or stock controlled by (say) Pennsylvania, is binding on those parties and their privies, and is entitled to full faith and credit in Pennsylvania. However, the significance accorded to the New York adjudication of *title* to the property—particularly as to the rights of third persons not directly bound by the New York judgment—remains within the control of Pennsylvania.[65]

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[64] *Broderick* v. *Rosner*, 294 U. S. 629, *at* 643-4 (1935, *per* BRANDEIS, J.). *First citation: Converse* v. *Hamilton*, 224 U. S. 243, *at* 260 (1912, *per* VAN DEVANTER, J.).

[65] *Green* v. *Van Buskirk*, 5 Wall. (72 U. S.) 307 (1867, *per* MILLER, J.), 7 Wall. (74 U. S.) 139 (1869, *per* DAVIS, J.); *Fall* v. *Eastin*, 215 U. S. 1 (1909, *per* MCKENNA, J.; HOLMES, J., *concurring*, 215 U. S. *at* 15); *Bank of America Nat. Tr. & Sav. Assn.* v. *Parnell*, 352 U. S. 29 (1956, *per* FRANKFURTER, J.); *Irving Trust Co.* v. *Maryland Cas. Co.*, 83 F. 2d 168 (2d Cir., 1936, *per* L. HAND, J.), *cert. den.* 299 U. S. 571 (1936); *see Goodrich, Two States and Real Estate*, 89 U. Pa. L. Rev. 417 (1941).

These principles apply both to the stock-claimants' ownership of Nazareth *stock* if valid, and to their ownership of Nazareth *assets* if the stock is void and if a trust is impressed on the assets.

(i) There is no conflict of Pennsylvania and New York laws ("whole law" or "internal law") as to ownership of *stock*. Pennsylvania has effectually ceded absolute control over determination of stock ownership by legislating that title to shares depends on title to the share certificates, at least where the other state with "contact" has comparable law in force (as here).

During the period of the stock-purchase transactions involved in Nazareth (1951-53), both the Uniform Sales Act and the Uniform Stock Transfer Act were in force in both Pennsylvania and New York. These statutes have been supplanted by the Uniform Commercial Code, effective in Pennsylvania since 1954, and to become effective in New York in 1964. The Code makes no material change in the internal law applicable in *Nazareth;* in most respects, the Code expressly adopts and clarifies the prior internal law, both statutory and judge-made.

In both states, under the Uniform Acts and the Code, title to valid stock depends on title to the negotiable stock certificates, not on the domicile or on registration on the corporate books. The *transfer* of the stock certificates, and of the shares represented thereby, determines the applicable law on ownership among competing stock-claimants. The conflicts rules are those involving sales and transfers of chattels and other negotiable paper, and those involving promises to sell and transfer chattels and other negotiable paper.[66]

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[66] *Direction der Disconto-Gesellschaft* v. *U. S. Steel Corp.*, 267 U. S. 22 (1925, *per* HOLMES, J.); *United Cigarette Mach. Co., Inc.* v. *Can. Pac. Ry. Co.*, 12 F. 2d 634 (2d Cir., 1926, *per* MANTON, J.); *Mill* v. *Jacobs*, 333 Pa. 231, 4 A. 2d 152 (1939, *per* DREW, J.); *Soltz* v. *Exhibitors Svc. Co.*, 334 Pa. 211, 5 A. 2d 899 (1939, *per* LINN, J.); *Lesavoy Industries, Inc.* v. *Pa. Gen. Paper Co.*, 404 Pa. 161, 171 A. 2d 148 (1961, *per* COHEN, J.). *See In re Rosen*, 157 F. 2d 997, *at* 999 (3d Cir., 1946, *per* GOODRICH, J.), *cert. den.* 330 U. S. 835 (1947).

(ii) Conflict of Pennsylvania and New York internal laws does appear *contingently* in only one respect, the purchase-money resulting trust. New York has abolished that form of trust, and thus bars the remedy below. Pennsylvania, short of abolition, has so curtailed the resulting trust that its rules of decision also bar the remedy below. Conflict of laws would occur only if the federal court were to modify the purchase-money resulting trust impressed below in order to conform it to Pennsylvania internal law. The trust would still be barred by New York internal law.

The resulting trust and the constructive trust are equitable *remedies*, applied judicially as two devices among many to enforce adjudicated rights where the legal remedy is inadequate (*e.g.*, money judgment) or unavailable (*e.g.*, impression of a lien on foreign realty). The cause of action arises from fraudulent *conduct*, not from an express contract or conveyance, and is "transitory," not "local." In such situations, the situs of the realty does not determine the applicable law governing the rights of the parties *inter se*. The choice of law as to *remedial trusts* is the same as the choice of law as to *rights* arising from tortious frauds and "implied" contracts.[67]

In *Nazareth*, all the stock-claimants made their stock-purchase contracts with Malakoff in New York, and paid the price to Malakoff in New York. At least half of them received letter-receipts from Malakoff which stated: "It is contemplated that the construction, performance, and execution of our understanding shall be governed by the Laws of the State of New York." The acceptance and affirmation of those contracts constitutes a private choice of law which is

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[67] *Massie* v. *Watts*, 6 Cranch (10 U. S.) 148 (1810, *per* MARSHALL, *C. J.*); *Irving Trust Co.* v. *Maryland Cas. Co.*, *supra*, n. 65; *Coffey* v. *Managed Properties, Inc.*, 85 F. 2d 88, *at* 90 (2d Cir., 1936, *per* A. N. HAND, *J.*); *Mandley* v. *Backer*, 121 F. 2d 875 (D. C. Cir., 1941, *per* GRONER, *C. J.*); *see Goodrich*, *op. cit. supra*, n. 65.

virtually determinative here.[68] All the Nazareth stock certificates were executed and delivered to the stock-claimants in New York. Most of the stock-claimants reside in New York, as did Malakoff. In sum, a stock-claimant's ownership of a "share" or "interest" which *he* bought from Malakoff in New York, depends on New York law, whether his acquisition was by an express contract executed and to be performed in New York, or by transfer of a stock certificate in New York, or by judicial impression of a trust on Malakoff's assets in consequence of Malakoff's wrongdoing in New York. New York law would not impress a purchase-money resulting trust.

A stock-claimant's right to subtract from or subordinate another stock-claimant's "share" or "interest" similarly acquired, depends on the relative equities in the stock or the realty (depending in turn on whether corporate stock or trust "interests" are awarded). In that respect, each stock-claimant is a third party as against every other stock-claimant. If stock is awarded, the equities of third parties depend on New York law. If trust "interests" are awarded, the equities of third parties depend on Pennsylvania law. There is no conflict of laws as to the rights of third parties. The only conflict involves the *availability* of a purchase-money resulting trust, and should be resolved by applying New York law, barring such a trust altogether.

(c) As to the federal court's choice of applicable state law in nondiversity cases where conflict of state laws appears:

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[68] *Haag* v. *Barnes*, 9 N. Y. 2d 554, *at* 559-560, 216 N. Y. S. 2d 65 (1961, *per* FULD, *J.*); *Hutchison* v. *Ross*, 262 N. Y. 381, 187 N. E. 65 (1933, *per* LEHMAN, *J.*); *Industrial Packaging Products Co.* v. *Ft. Pitt Packaging Intl., Inc.*, 399 Pa. 643, 161 A. 2d 19 (1960, *per* JONES, *J.*); 12A Purdon's Pa. Stats. Ann. [Uniform Commercial Code] § 1-105(1), P. L. 3 (1953) § 1-105, *amended* P. L. 1023 (1959) § 1; *Seeman* v. *Phila. Warehouse Co.*, 274 U. S. 403 (1927, *per* STONE, *J.*).

Here, no federal statute has even been invoked with respect to the substantive rights of the parties. The only applicable federal statute relating to choice of applicable state law, is the Rules of Decision Act itself. Its language—"The laws of the several states, * * *, shall be regarded as rules of decision * * *, in cases where they apply."—furnishes little or no guide, and has not been authoritatively interpreted on the question.

(i) If the federal nondiversity court and the state courts with "contact" would all apply the same conflicts of law rules, the choice-of-law problem would probably be as academic as if the internal laws were not in conflict. The New York courts have expressly adopted the *ad hoc* "grouping of significant contacts" or "center of gravity" rule or theory, based on the facts and the issues of the particular case, for all litigation; and the Pennsylvania legislature, by its 1959 amendment of the Uniform Commercial Code, has effectually adopted the same rule as to commercial transactions.[69] Mechanical choice-of-law formulas are eschewed. The rule is a realistic acknowledgment of what used to be judicially accomplished and rationalized by inferring "intent" and implying private stipulations of applicable law, especially to validate contracts and property transfers. This Court has suggested adoption of the same flexible "center of gravity" rule.[70] Traditional rules would also apply the law of New York—the place the stock purchase contracts with Malakoff were made and were performed by delivery of the stock certificates, and the place of Malakoff's wrongdoing.

(ii) Wolf submits that a federal bankruptcy court, applying state law under the Rules of Decision Act and no

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[69] *Auten* v. *Auten*, 308 N. Y. 155, 124 N. E. 2d 99 (1954, *per* FULD, *J.*); *Haaa* v. *Barnes*, *supra*, n. 68; 12A Purdon's Pa. Stats. Ann. [Uniform Commercial Code] § 1-105 (1), P. L. 3 (1953) § 1-105, *amended* P. L. 1023 (1959) § 1.

[70] *See Cope* v. *Anderson*, 331 U. S. 461 (1947, *per* BLACK, *J.*). *See also* 1A Moore's Fed. Prac. (2d ed. 1961) ¶ 0.325.

other federal statute in a *commercial* nondiversity case, should make a *provisional* choice of state law based on the federal court's own "grouping of significant contacts"— a mixed question of fact and law. The state law chosen should be the *whole law* (which is what would make the federal court's choice provisional), particularly because state legislatures are incorporating choice-of-law provisions into *commercial* statutes, notably the Uniform Commercial Code.

(iii) The forum state's conflict-of-laws rules should be applied to the remedies and the "procedural" defenses only if the parties might reasonably have litigated the same matter in a state forum in that state.

The contingent conflict of laws in this case relates to the availability of an equitable *remedial* trust under state law, and is an example of the most serious conflict-of-laws problems which relates to defenses and remedies peculiar to the litigation process itself rather than to pre-litigation rights and liabilities (*e.g.*, time-bars, "public policy" against enforcement of a claim or defense created by foreign state law). *Klaxon*, following *Erie*, held that there was no "independent 'general law' of conflict of laws" in *diversity* cases; the *forum* state's conflict-of-laws rules governed the federal diversity court in all respects, because the federal court was sitting as "only another court of the State."[70a]

The Chapter X court has no such relationship to the forum state in summary proceedings involving the allowance of claims. More importantly, the litigation of disputed ownership of the debts or stock underlying the claims, by way of cross-claims between the claimants, has no relationship to the forum state, especially when there is no serious question of allowance of the claim as against the debtor. That is the situation here. The Debtor chose a New York

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[70a] *Klaxon Co. v. Stentor Electric Mfg. Co., Inc.*, 313 U. S. 487 (1941, *per* REED, J.). *Cf. Griffin v. McCoach*, 313 U. S. 498 (1941, *per* REED, J.) (*interpleader*).

forum for convenience; any impropriety was a matter of "venue," not "jurisdiction," and waivable.[70b] The stock-claimants appeared generally in response to bar orders, to avoid forfeiture of stock which was *not* worthless because the Debtor was *not* insolvent in the bankruptcy (balance sheet) sense. (Otherwise, the stock-claimants would not have filed claims, and the Debtor's recourse would have been plenary actions in New York to collect assessments for the benefit of creditors.) If the Debtor had filed its Chapter X petition in Philadelphia, and had brought the stock-claimants into proceedings there, the application of Pennsylvania conflict-of-laws rules could not be justified simply by reference to the forum state. New York conflict-of-laws rules as to remedies and "procedural" defenses *incident to the litigation*, should be applied here by a federal nondiversity court *because* New York is where the stock-claimants would hypothetically have litigated the disputed *ownership* of Nazareth stock, except for the happenstance of the Debtor's Chapter X petition and the Debtor's challenge to *validity* of all outstanding Nazareth stock. A New York court, even if it decided to award "interests" in Nazareth *assets*, would not impress a purchase-money resulting trust as an equitable remedy.

[70b] *See* 6 *Collier on Bankruptcy* (14th ed.) ¶ 4.11.

B. Having received the Market (realty and business) in consideration of the issuance of all its authorized shares of stock, the Debtor and its stockholders derivatively are not aggrieved by the validation and allowance of the entire authorized issue of 200 shares, pursuant to applicable state rules of decision.

The decisions below stand—or fall—on the conclusion of law that *all* outstanding Nazareth shares are absolutely void under Pennsylvania law, on the ground of lack of consideration to Nazareth for issuance of those shares. The Examiner stated, and the District Judge implicitly concurred:

> "91. * * * not one of the thirty-six persons who have filed proofs of stock interest * * * has a clear legal right to any of the shares which he or she claims. * * * all of the issued shares of stock of the debtor herein are at least voidable." (R. 192)
>
> "92. * * * The factual objection that no consideration passed to the debtor must be sustained. That is true as to all stock claims. Consequently on the basis of the debtor's objections there would be no stockholders. * * *" (R. 192-3)
>
> "136. If the claimants-stockholders invested in Nazareth the business enterprise and not Nazareth, the corporate entity, there is no problem of consideration to the debtor itself. Consideration to Malakoff can be treated as consideration to the debtor, justifying the sustaining of the claims of stock interest interposed by the claimants-stockholders herein on the basis of such consideration. * * *" (R. 207)

Speaking for the Court of Appeals, Judge Moore wrote:

> "* * * From these persons [disallowed] the Debtor did not receive and was not intended to receive anything of value, either from them or *from Malakoff*.

> These shares as a matter of Pennsylvania law could have had no validity as an original issue. * * *" (R. 591; *emphasis supplied.*)
>
> "Despite the cloud of illegality obscuring *any* stock issuance, the Debtor came into corporate being and did acquire a valuable property which it still holds. *The Market property is sufficient to support a valid stock issue* to those entitled thereto. The sellers (Philadelphia group) have been paid for that property *by Malakoff*. * * *" (R. 592; *emphasis supplied.*)

In other words, the Market was paid for by Malakoff, and is sufficient consideration under Pennsylvania law for the issuance of *new* stock for purposes of a plan of reorganization—but the Market is *not* sufficient consideration under Pennsylvania law for the issuance of *old* stock for purposes of the allowance of claims!

1. *The first 20 shares of Nazareth stock were regularly issued for sufficient consideration to Nazareth, and remain valid and outstanding, notwithstanding irregularity in their transfer.*

Both Courts recognized that the first 20 shares had been *validly* issued to the representatives of the Philadelphia Group (*viz.*: Zoloth and Soble), and had been sold by them to Malakoff (R. 54-7, 185-6, 231, 588-9, 592). To support their common thesis that *all* outstanding shares were void, both Courts below had to disregard those first 20 shares. They did. The rationale was stated by Judge Moore, thus:

> "* * * The 20 *shares* originally issued to Zoloth and Soble, although subsequently assigned to Malakoff and still later by him to the Debtor, did not come into the *hands* of any claimant. * * * *Thus* no claimant can derive any rights by assignment from Malakoff on the theory that he was the owner of the Debtor's stock. * * *" (R. 592; *emphasis supplied.*)

That statement is erroneous. It was the share *certificates*—not the shares—which "did not come into the hands of any claimant."

(a) What Judge Moore is saying, is that Malakoff, by assigning to Nazareth the first two *certificates*, and the first 20 validly issued shares represented by those certificates, cut off any rights in those shares which any of the stock-claimants here might have had. If Malakoff had merely surrendered or cancelled the 20 shares, the transaction would have approximated the usual indorsement and delivery of the certificates to the purchasers, plus submission of those certificates to the issuer-corporation for transfer of the shares on the corporate books and for issuance of new certificates to the purchasers. The transactions, and Judge Moore's statement, are meaningful only if Nazareth was acquiring treasury shares validly issued. Malakoff's assignment to Nazareth is governed by the same principles as Malakoff's assignment to any individual stock-claimant.[71]

"*Title* to a certificate *and* to the *shares* represented thereby can be transferred only" by delivery of the *indorsed* certificate or by delivery of the certificate *accompanied* by a separate instrument of assignment or stock power,[72] "'Title' means legal title and does not include a merely equitable or beneficial ownership or interest."[73] Thus, the common-law doctrine that legal title passed upon transfer of the shares on the corporate books, has been supplanted by importing negotiability to stock certificates.[74] As *among competing*

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[71] *See, e.g., Moores* v. *Citizens Nat. Bank*, 111 U. S. 156 (1884, *per* GRAY, *J.*).

[72] N. Y. Pers. Prop. L. (L. 1913, c. 600) (49 McKinney's N. Y. Consol. L.) § 162; 15 Purdon's Pa. Stats. Ann. § 301, P. L. 126, § 1 (1911) (*repealed* 1954); Uniform Stock Transfer Act, § 1 (*emphasis supplied*).

[73] N. Y. P. P. L. § 183(1); 15 Purdon's Pa. Stats. Ann. § 322 (1); U. S. T. A., § 22(1) (*supra*, n. 72).

[74] *Soltz* v. *Exhibitors Svc. Co.*, 334 Pa. 211, *at* 215, 5 A. 2d 899 (1939, *per* LUSK, *J.*).

stock-claimants, "legal title" to shares depends on ownership of a negotiable certificate; the corporate books are immaterial (much as the corporation's accounts-payable ledger is not definitive of ownership of a debt evidenced by a negotiable note). *As between the issuer-corporation and competing stock-claimants*, the old doctrine about transfer on the corporate books, at least where adopted in the corporate charter or by-laws (as here [75]), continues to protect the corporation—for purposes of dividend payments, stockholder voting, and assessment.[76]

But "legal title" to a certificate (and the shares) prevails over a prior assignment of those shares unaccompanied by the certificate *only* "if * * * another person, for value in good faith, *and without notice of the prior transfer*, shall purchase and obtain delivery of such certificate * * *." [77] The earlier assignment is not nugatory though unaccompanied by the certificate; and the certificate is not the *sine qua non* of assignment. The certificate relates to negotiability and to defenses and equities among competing stock-claimants.[78]

> "§ 171. An attempted transfer of title to a certificate *or* to the *shares* represented thereby without delivery of the certificate shall have the effect of a promise to transfer and the obligation, if any, imposed

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[75] Nazareth By-Laws, Art. VIII, § 2; Saul General Examiner's Exh. I; R. 168 [*not printed*].

[76] N. Y. P. P. L. §§ 162, 164; 15 Purdon's Pa. Stats. Ann. §§ 301, 303, U. S. T. A. §§ 1, 3 (*supra*, n. 72).

[77] N. Y. P. P. L. § 165; 15 Purdon's Pa. Stats. Ann. § 304; U. S. T. A. § 4 (*supra*, n. 72) (*emphasis supplied*).

[78] *Parsons* v. *Life*, 158 M. 32, 280 N. Y. S. 60 (Sup., Onondaga, 1933, *per* SMITH, *J.*), *aff'd* [*sub nom. Parsons* v. *First Tr. & Dep. Co.*] 243 A. D. 681, 277 N. Y. S. 426, 428 (4th Dept., 1935, *per*), *aff'd* 269 N. Y. 630, 200 N. E. 31 (1936, *memo*); *Suchy* v. *Frankenberg*, 251 A. D. 349, 296 N. Y. S. 545 (1st Dept., 1937, *per* UNTERMYER, *J.*); Connell's *Estate*, 282 Pa. 555, 128 A. 503 (1925, *per* SADLER, *J.*); *Citizens' Nat. Bank* v. *Ircin B. & L. Assn.*, 316 Pa. 536, 175 A. 399 (1934, *per* FRAZER, *C. J.*); *Leff* v. *N. Kaufman's, Inc.*, 342 Pa. 342, 20 A. 2d 780 (1941, *per* DREW, *J.*).

by such promise shall be determined by the law governing the formation and performance of contracts." [79]

By the time Nazareth acquired the first 20 shares on June 17, 1953, Malakoff had made his stock-purchase contracts with *all* 36 stock-claimants here, and had thereby promised them shares of Nazareth stock—mostly at times when the only shares to which he himself had legal title were those same 20 shares evidenced by those same first two stock certificates. Nazareth was not "without notice of the prior transfer" of shares by Malakoff: Malakoff had been president of Nazareth, and the Nazareth books themselves reflected the prior issuance of shares sold by Malakoff.

(b) The first 20 *shares*, represented by the first two stock certificates, did pass to some of the stock-claimants. The foregoing principles determine their rights, *inter se*, to those shares. Since none of them had ever acquired delivery of the certificates, "legal title" to the shares remained in Malakoff. As stated in an apposite New York case (where one Frankenberg had first pledged stock certificates without indorsing them, then had sold the same shares without delivering the certificates):

> "* * * The legal title remained at all times in Frankenberg since it had not been transferred either to the plaintiff or to the corporate defendant in the only manner in which the statute (Personal Property Law, § 162) provides that it may be done. The plaintiff did not acquire the legal title because he failed to secure indorsement of the certificates; the corporation did not acquire legal title because it failed to secure delivery of the certificates properly indorsed.

[79] N. Y. P. P. L. § 171; 15 Purdon's Pa. Stats. Ann. § 310; U. S. T. A. § 10 (*supra*, n. 72) (*emphasis supplied*). *See also* N. Y. P. P. L. § 179; 15 Purdon's Pa. Stats. Ann. § 318; U. S. T. A. § 18 (*supra*, n. 72).

"In the presence of such conflicting equities, the rule of law is settled that 'the one that is *prior in time is superior in right.*' [Citation.] * * *"[80]

The priorities of competing claimants, both holding equities of ownership, but neither holding legal title, are determined as of the times they acquired their respective equities. The later-acquired equity, otherwise inferior to the earlier, is *not* elevated to superiority by the mere acquisition of legal title without new contemporaneous consideration *then*.[81] *Legally*, every delivery of a Nazareth stock certificate 18 months after payment to Malakoff for those shares, was in consideration of an "antecedent debt."

In *Nazareth*, one stock-claim (at least) carries an absolute right to part of those first 20 shares, *viz.*: the stock-claim of Charles Kanter (one of Wolf's assignors). Early in February of 1953, Kanter received Certificate No. 4 for 12 shares, dated February 2, 1953. The Nazareth stock certificate book —the only Nazareth record of its stockholders (R. 187)— registered that issuance. Kanter had paid Malakoff $4,000 on April 10, 1951, contemporaneously with Kanter's agreement with Malakoff that Kanter was to receive $\frac{1}{4}$ of Malakoff's $\frac{1}{4}$ interest in what was then the Philadelphia Group joint venture in the Market. Kanter's $4,000 advance to Malakoff has been judicially traced into Malakoff's down-payment to the Philadelphia Group for the purchase of the Market. Kanter was expressly exonerated of any participation in Malakoff's machinations, and of any knowledge thereof (R. 57-63, 230, 232, 595). Kanter was thus the beneficiary of an express trust in $\frac{1}{4}$ of Malakoff's shares, or a $\frac{1}{16}$ interest in the Nazareth Market, and in the corporation when later

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[80] *Suchy* v. *Frankenberg*, *supra*, n. 78, 296 N. Y. S. at 548 (*emphasis supplied*). *See cases cited supra*, n. 78.

[81] *See Central Trust Co.* v. *West India Improvement Co.*, 169 N. Y. 314, 62 N. E. 387 (1901, *per* Gray, J.); *Suchy* v. *Frankenberg*, *supra*, n. 78.

organized, whether Malakoff's shares amounted to 20 or 200; and Kanter could have enforced that trust as against Malakoff, whether Kanter be viewed as a joint venturer of Malakoff's[82] or as a pre-incorporation subscriber to Nazareth stock.[83] The issuance to Kanter of the 12 shares represented by Certificate No. 4, legally perfected his rights to those shares, theretofore cognizable in equity.

(c) If those same principles determined equitable ownership of Nazareth shares additional to the first 20—however many were validated, if less than all 262 outstanding—then the simple sequence of purchases from or through Malakoff would govern. Every stock-claimant would be denied the status of a "*bona fide* purchaser for value and without notice" of prior transfers; no stock-claimant could cut off anyone's earlier-acquired equities in Nazareth "shares". For the stock-claimants all acquired certificates directly from Nazareth (excepting a few purchasers at the end), without negotiation to constitute them holders in due course. Their equities depend equally on transactions with Malakoff. The Court of

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[82] *Nastasi* v. *Moore*, 7 M. 2d 226, 156 N. Y. S. 2d 521 (Sup., N. Y., 1956, *per* McGIVERN, *J.*); *East Lake Lumber Co.* v. *Van Gorder*, 105 M. 704, 174 N. Y. S. 38 (Sup., Erie, 1919, *per* COLE, *J.*), *aff'd* 188 A. D. 997, 177 N. Y. S. 914 (4th Dept., 1919, *memo*).

[83] *Bole* v. *Murray*, 233 Pa. 589, 82 A. 943 (1912, *per* STEWART, J.); *Bole* v. *Fulton*, 233 Pa. 609, 82 A. 947 (1912, *per* STEWART, *J.*); *Schwartz* v. *Mfrs. Cas. Ins. Co.*, 335 Pa. 130, 6 A. 2d 299 (1939, *per* DREW, *J.*); *Burr* v. *Wilcox*, 22 N. Y. 551 (1860, *per* CLERKE, SELDEN, *JJ.*); *Yonkers Gazette Co.* v. *Taylor*, 30 A. D. 334, 51 N. Y. S. 969 (2d Dept., 1898, *per* HATCH, *J.*); *Beals* v. *Buffalo Expanded Metal Constr. Co.*, 49 A. D. 589, 63 N. Y. S. 635 (4th Dept., 1900, *per* SPRING, *J.*); *Sanders* v. *Barnaby*, 166 A. D. 274 151 N. Y. S. 580 (1st Dept., 1915, *per* SCOTT, *J.*); *Mills* v. *Friedman*, 111 M. 253, 181 N. Y. S. 285 (Sup., Albany, 1920, *per*, HINMAN, *J.*), *aff'd* 194 A. D. 942, 184 N. Y. S. 613 (3d Dept., 1920, *p.c.*); *Mills* v. *McNamee*, 111 M. 253, 181 N. Y. S. 285 (Sup., Albany, 1920, *per* HINMAN, *J.*), *aff'd* 194 A. D. 932, 184 N. Y. S. 613 (3d Dept., 1920, *p.c.*), *aff'd* 233 N. Y. 517, 135 N. E. 899 (1922, *memo*); Applications of Friedman, 184 M. 639, 54 N. Y. S. 2d 45 (Sup., N. Y., 1945, *per* MILLER, *J.*), *mod.* 269 A. D. 834, 56 N. Y. S. 2d 516 (1st Dept., 1945, *p.c.*).

Appeals' classification of the stock-claimants was based on the finding that some or all of the consideration for the stock cancelled below (*i.e.*, the disallowed stock-claims) was credit for antecedent indebtedness to Malakoff himself, and on the finding and/or conclusion that, as to those whose stock-claims were allowed, "Malakoff as the promoter must be regarded as a trustee, fiduciary, agent, promoter or syndicator (the terminology is unimportant—the facts create the rights) for those who gave him their funds for investment in the project" (R. 592-4). So the Debtor and the Weinstein-Fried Group had advocated (R. 47-50, 191).

True, an antecedent debt does not support a "good-faith purchase" or an estoppel sufficient to cut off prior equities.[54] But *notice*, too, disqualifies the would-be "good-faith purchaser." The Court of Appeals' decision would impute such disqualifying notice to *all* the stock-claimants who prevailed below *because* Malakoff was their agent or trustee in their acquisitions of Nazareth "shares". Malakoff was the "sole actor" for them.

> "Under these circumstances, we do not think the company can be treated as a *bona fide purchaser*. It is charged with Holbrook's knowledge because he was the *sole actor* for the company in procuring the fraudulent [land] patents.* * *"
>
> "* * * It is true that the more titles he got the more profit he would make out of the agency, and we may assume that, as between him and the company, in securing fraudulent titles for the company, he was violating his instructions; but he and the company were in a common adventure, and if the company insists on retaining the fruits of that adventure, it must be charged with the knowledge of the agent through

[54] *See, e.g., Wills* v. *Investors Bankstocks Corp.*, 257 N. Y. 451, *at* 458, 178 N. E. 755 (1931, *per* LEHMAN, *J.*).

> whom the fruits came.* * * The adverse interests, as between them, in sharing the fruits of the common business, cannot enable the company to retain its share and repudiate the agent with all he knew. * * *" [85]

Thus, with one class on "notice", and the other not having paid contemporaneous "value", all hold equally infirm titles; and equity would fall back on the maxim, "prior in time is superior in right". The calendar—or chance—would dictate: and the latest purchasers would be excluded.

No such result is advocated by any of the parties; no such result was reached by either Court below; and, fortunately, no such result is necessary here.

2. *Sufficient consideration passed to Nazareth to support its issuance of 200 outstanding shares, notwithstanding irregularity in the issuance of 180 shares.*

The *only* ground (other than overissue) for voiding corporate stock under Pennsylvania law, is lack of consideration to the issuer-corporation for such stock. Irregularities in the issuance, even statutory violations, will not void the stock. Irregularities abounded in the issuance of Nazareth stock; but there was no lack of consideration for the issuance of 200 shares. The Pennsylvania Business Corporation Law provides:

> "§ 610. Validity of Shares.—The fact that shares are issued in violation of, or without full compliance with, the provisions of this act *shall not make the shares so issued invalid*, unless they are issued in

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[85] Curtis, Collins, & Holbrook Co. v. U. S., 262 U. S. 215, *at* 222, 224 (1923, *per* TAFT, *C. J.*). *Accord: Munroe* v. *Harriman*, 85 F. 2d 493 (2d Cir., 1936, *per* SWAN, *J.*), *cert. den.* 299 U. S. 601 (1936); *Holden* v. *N. Y. & Erie Bank*, 72 N. Y. 286 (1878, *per* FOLGER, *J.*); *Scouton* v. *Stony Brook Lumber Co.*, 261 Pa. 241, *at* 246, 104 A. 548 (1918, *per* WALLING, *J.*).

violation of Article XVI, Section seven, of the Constitution of this Commonwealth." [86]

The Pennsylvania Constitution provides:

> "[XVI] § 7. No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. * * *" [87]

(a) What both Courts below have ignored, is that the statutory protection runs to the issuer-corporation. If the corporation receives consideration, the stock is valid—notwithstanding that the person who pays the consideration is not the recipient of the stock.

> "* * * the Smoaks did not pay any money or transfer any property to the corporation, or perform any labor for it, in payment for the stock issued to them. * * * *The statute does not require that corporation stock must be paid for by the money, labor or property of the person to whom it is issued. It merely requires that the corporation shall receive full value for all of the stock issued.* This requirement was fully met by the conveyance to the corporation by the plaintiff of property whose value was far in excess of the amount of the capital stock. The fact that plaintiff had entered into an agreement to issue one-half of this stock to the defendant Smoak or his nominee, and that such agreement was performed, in no way alters the fundamental proposition that the corporation itself had received full value. This was sufficient to satisfy the statute, and in the absence of fraud, plaintiff may not

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[86] Pa. Bus. Corp. L. § 610; 15 Purdon's Pa. Stats. Ann. § 2852-610; P. L. 364, Art. VI; § 610 (1933) (*emphasis supplied*).

[87] Pa. Const. Art. XVI, § 7 (1874, 1956). *See* Pa. Bus. Corp. L. § 603A (*supra*, n. 86).

> void his contract [with Smoak] on the theory of a statutory violation." [88]

(b) Having received the Market (realty and business), and having paid therefor in stock alone—not money—it is really beyond reasonable question that Nazareth received *some* consideration for the issuance of *some* of its stock. Reasonable question can be addressed only to *how much* Nazareth received; whether the consideration was *sufficient* to support issuance of *all* the outstanding shares (not to exceed 200); and, if not, *how many* shares are supported by the consideration received by Nazareth in fact.

Judge Moore stated, "The Market property [paid for by Malakoff] is sufficient to support a valid stock issue to those entitled thereto." (R. 592) So the District Judge and the Examiner had said. No reason is given—and there is no reason—why the Market should not be sufficient in *value* to support a valid stock issue—old or new—to *all* the stock claimants.

The Examiner found that the price of the Market to Malakoff was $89,989 (R. 57). The District Judge found that the price of the Market to Malakoff was $66,000 "plus an unresolved amount." (R. 231) The District Court awarded "shares" or "interests" in Nazareth to all 36 stock-claimants in No. 27000 (excluding and reserving the Margolis Group), who had paid Malakoff an aggregate, in "net fair value of investment in the debtor," found to be $173,457.53 (R. 263). Judge Moore stated that Malakoff had paid the Philadelphia Group $77,010.84 (R. 589). The Court of Appeals awarded "shares" or "interests" in Nazareth to 33 of

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[88] *Winston* v. *Saugerties Farms, Inc.*, 262 A. D. 435, 29 N. Y. S. 2d 292, *at* 296 (3d Dept., *per* FOSTER, *J.*), *aff'd* 287 N. Y. 718, 29 N. E. 2d 934 (1942, *p.c.*). *Accord: Schmidt* v. *Paul*, 377 Pac. 377, 105 A. 2d 118 (1954, *per* STEARNS, *J.*); *Nastasi* v. *Moore*, 7 M. 2d 226, 156 N. Y. S. 2d 521 (Sup., N. Y., 1956, *per* MCGIVERN, *J.*).

the 41 stock-claimants in No. 27000 and No. 26962 (including some of the Margolis Group), who had paid Malakoff an aggregate, in "investment" in the Market, found to be $145,287.34 (R. 594-5, 598).

Neither Court below had the slightest concern for any *per-share* consideration to Nazareth in dollars. The Judges and the parties—were indifferent to the actual value of the Market, and to Malakoff's profits in selling "shares" to the stock-claimants. The Market was to constitute the consideration to Nazareth for issuance of *all* the shares judicially validated, irrespective of how many such shares. Thus, the Market is sufficient consideration to validate any number of Nazareth shares now issued and outstanding—within the authorized limit of 200.

(c) The defects in issuance of Nazareth shares (apart from overissue) are matters of *irregularity, not invalidity.*

The validity of the first 20 shares has been discussed above. The other 180 shares within the authorized limit of 200, have been challenged because the attempt to regularize their issuance occurred subsequent to issuance, and because the corporate records erroneously stated the consideration to Nazareth for that issuance. Judge Moore wrote:

> "After the shares had been issued to the claimants from and after February 2, 1953, corporate minutes in May or June, 1953, were fraudulently prepared and pre-dated as of July 2, 1952 (or post-dated July 2, 1953) purporting to evidence the issuance of the remaining 180 shares to Malakoff for $75 a share. There is no proof that Malakoff ever paid for these shares or that they were legally issued. Thus no claimant can derive any rights by assignment from Malakoff on the theory that he was the owner of the Debtor's stock. The purported issuance was both fraudulent and invalid." (R. 592)

The Nazareth minutes referred to, expressly stated that the price of the 180 shares was to be the same $75 per share as the price of the first 20 shares, and that the aggregate price of $13,500 for the 180 shares was to be charged against Nazareth's loans payable to Malakoff, then shown on the Nazareth books as $66,092.92 (Saul General: Examiner's Exh. I; R. 535-6, 168).

A corporation may validly act without formal meetings of stockholders and directors, and without formal minutes and resolutions. The corporate records are not conclusive; parol evidence is admissible to clarify and correct. In the event of controversy, it devolves upon the courts to penetrate the fictions on the records and to ascertain the realities.[89]

The amount of consideration—the subscription price—to be paid to the corporation for an original issuance of *no-par* shares, is determined by the incorporators before incorporation, and by the directors after incorporation. Where the subscription price is paid in property rather than money (as in *Nazareth*), the valuation of that property by the incorporators or directors is conclusive, absent actual fraud.[90] The consideration for the shares need not be pre-paid. The time of payment of the subscription price is expressly left by statute to the discretion of the incorporators or directors and to the subscription contracts.[91]

The realities in *Nazareth* are that Malakoff himself paid the Philadelphia Group at least $60,000 for the Market

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[89] *E.g., Schmidt* v. *Paul*, 377 Pa. 377, 105 A. 2d 118 (1954, *per* STEARNE, *J.*); *Moss* v. *Averell*, 10 N. Y. 449 (1853, *per* WILLARD, *J.*); *Handley* v. *Stutz*, 139 U. S. 417 (1891, *per* BROWN, *J.*).

[90] Pa. Bus. Corp. L. § 603A (*supra*, n. 86). *See Maguire* v. *Osborne*, 388 Pa. 121, 130 A. 2d 157 (1957, *p.c.*); *Schmidt* v. *Paul*, *supra*, n. 89.

[91] Pa. Bus. Corp. L. § 604 (*supra*, n. 86); *Petrishen* v. *Westmoreland Fin. Corp.*, 394 Pa. 552, 147 A. 2d 392 (1959, *per* JONES, *J.*); *Grafton* v. *Masteller*, 232 F. 2d 773 (3d Cir., 1956, *per* HASTIE, *J.*), *cert. den.* 352 U. S. 832 (1956).

(assets) and for *all* the issued and outstanding Nazareth shares, and that the first 20 shares were later split, 10-for-1. The 200 authorized shares should have been capitalized at no less than $60,000 after Malakoff released his claim to the loans payable by Nazareth and after he released all his interest in shares in his name. Indeed, it would be still more accurate for the corporation's acquisition cost to be shown on its books as $89,989, the total price Malakoff agreed to pay the Philadelphia Group for the Market (assets) *plus* the first 20 shares—*i.e.*, the total price for which the Philadelphia Group credited Malakoff.

Good accounting practice warrants appraisal of tangible assets, especially realty, and re-valuation on the books, in order to portray asset value and net worth accurately.[92] The Pennsylvania Business Corporation Law makes express provision for such re-valuation of assets to determine "capital" and "surplus" incident to certain statutory protection to creditors and stockholders.[93]

The minutes were drafted and signed in May and June of 1953. Malakoff had previously delivered every stock certificate. On July 2, 1953, he released his entire claim against Nazareth. The minutes induced no stock-claimant to change his position to his detriment. The fraud is academic. If those minutes had stated that Malakoff *then* released his

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[92] *See* Wixon, Accountants Handbook (Ronald, 1957), §§ 18:1-8, 18:22-36, 18:40-42, 19:14-16, 22:6-7.

[93] *E.g.*, Pa. Bus. Corp. L. §§ 701A(1), 701B; 15 Purdon's Pa. Stats. Ann. §§ 2852-701A(1), 701B; P. L. 364, Art. VII, § 701A(1), 701B (1933), *amended* P. L. 1123, § 1 (1935); *effectually recodified as* § 704B *by* P. L. 711, § 1 (1957). *See* Mulford, Corporate Distributions to Shareholders and Other Amendments to Pa. Bus. Corp. Law, 106 U. Pa. L. Rev. 536, at 544-5 (1958). *See also Edwards* v. *Douglas*, 269 U. S. 204 (1925, *per* BRANDEIS, *J.*); *Mountain State Steel Foundries, Inc.* v. *C. I. R.*, 284 F. 2d 737 (4th Cir. [W. Va.], 1960, *per* HAYNSWORTH, *J.*); *Randall* v. *Bailey*, 288 N. Y. 280, 43 N. E. 2d 43 (1942, *per* CONWAY, *J.*).

claim against Nazareth to *all* loans payable to him (not limited to $13,500), and that all 200 authorized shares were to be issued to Malakoff's designees for an aggregate consideration to Nazareth of between $60,000 and $90,000, those minutes would have been an accurate reflection of the financial realities of the Nazareth stock issuance. Thereby, those minutes would have stated in substance, what both Courts below have ruled in substance, *viz.*: that Malakoff paid the Philadelphia Group for the Market, and that the Market was consideration—and sufficient consideration—for the issuance of 200 shares to Malakoff's designees (purchasers). In short, those 1953 minutes require correction, not disregard.[94]

3. *Assessment of the unpaid subscription price is the state remedy prerequisite to cancellation of shares of stock, in order to permit redemption and to avoid forfeiture.*

(a) The Pennsylvania Constitution provides:

> "[XVI] § 7. No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. * * *"[95]

But the remedy is *not* cancellation of stock:

> "* * * However, the Pennsylvania cases are agreed that this constitutional provision [Art. XVI, § 7] standing alone, does not cause the issuance of stock without prepayment to be void. Rather, it is necessary that the legislature shall *implement* the constitutionally stated policy by a statute declaring the nature and extent of any infirmity which attaches

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[94] *See Coleman* v. *Huffman*, 8 Monroe L. R. 97 (C. P., Monroe, 1946, *per* BODIE, *P. J.*), *aff'd* 357 Pa. 232, 53 A. 2d 60 (1947, *per* STERN, *J.*).

[95] Pa Const., Art. XVI, § 7 (1874, 1956). *See* Pa. Bus. Corp. L. § 603A; 15 Purdon's Pa. Stats. Ann. § 2852-603A; P. L. 364, Art. VI, § 603A (1933).

to the stock so issued, and *what may be done about it*. [Pa. cases cited.]" [96]

(b) The Pennsylvania Business Corporation Law has "implemented" the Pennsylvania constitutional policy, in detail. The remedy for lack of consideration to the corporation for stock issued, is *assessment* or call—collectible like any other debt, and secured by a lien on the shares themselves. Cancellation may be effected *only* after foreclosure of the corporate lien on the stock, and then *only* if public sale brings no purchase or if the corporation fails to collect a money judgment for the deficiency.

> "§ 604. * * * Any call made by the board of directors for payment of subscriptions shall be uniform as to all shares of the same class, * * *. The directors shall cause notice of the amount of any call, and of the time and place of payment, to be given at least thirty days before the date the call is due; * * *. If a shareholder be indebted to a business corporation on account of unpaid subscriptions for shares, the corporation shall have a lien upon such shares for such indebtedness. * * *" [97]
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> "§ 605. When any shareholder fails to pay any call upon his shares properly made by the directors, at the time when such payment is due, the directors

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[96] *Grafton* v. *Masteller*, 232 F. 2d 773, *at* 775 (3d Cir., 1956, *per* HASTIE, *J.*), *cert. den.* 352 U. S. 832 (1956) (*Pa. forum; diversity jurisdiction; emphasis supplied*). *Citing (accord): Yetter* v. *Del Valley R. Co.*, 206 Pa. 485, 56 A. 57 (1903, *per* BROWN, *J.*); *Grange Nat. Bank* v. *Collman*, 306 Pa. 201, 159 A. 26 (1932, *per* FRAZER, *C. J.*); *Bradford County Telephone Co.* v. *Young*, 329 Pa. 433, 198 A. 96 (1938, *per* STERN, *J.*); *In re Dissolution of* New Oxford Shoe Co., 45 Pa. D. & C. 53 (C. P., Adams, 1941, 1942, *per* SHEELY, *P. J.*). *Accord: Kathiotes* v. *Mosler*, 89 Pa. D. & C. 174 (C. P., Phila., 1955, *per* ALESSANDRONI, *J.*); *Bell* v. *Aubel*, 151 Pa. Super. 569, 30 A. 2d 617 (1943, *per* RHODES, *J.*). *See also Petrishen* v. *Westmoreland Fin. Corp.*, 394 Pa. 552, 147 A. 2d 392 (1959, *per* JONES, *J.*).

[97] Pa. Bus. Corp. L. § 604; 15 Purdon's Pa. Stats. Ann. § 2852-604; P. L. 364, Art. VI, § 604 (1933).

> may proceed to collect the amount due in the same manner as any debt due the corporation, or they may sell, at public sale, such part of the shares of the delinquent shareholder as will pay all or any part of the installments then due from him. * * *. If no bidder can be had to pay the amount due on the shares, if the amount is not collected by an action at law * * *, the shares shall be forfeited to the corporation and the amount previously paid in by the delinquent shareholder on the shares shall be forfeited to the corporation. * * * "[98]

Transferees of subscriptions (as well as issued shares) are exonerated from personal liability for unpaid subscriptions if their acquisitions were made "in good faith, and without knowledge or notice that the full consideration therefor has not been paid, * * *."[99] The corporation's foreclosure of any lien on the stock—including a lien for the subscription price—is barred where (as here) the stock certificates issued by the corporation bear no statement asserting such a lien.[100] The common law has been changed, and the rigorous principles of estoppel have been relaxed in favor of the transferee, as to both his personal liability to assessment[101] and the *in rem* charge on his shares for prior secret liens.[102]

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[98] Pa. Bus. Corp. L. § 605 (*supra*, n. 97).

[99] Pa. Bus. Corp. L. § 609 (*supra*, n. 97).

[100] 15 Purdon's Pa. Stats. Ann. § 315; P. L. 126, § 15 (1911) (*repealed* 1954); Uniform Stock Transfer Act § 15; N. Y. Pers. Prop. L. (L. 1913, c. 600) (49 McKinney's N. Y. Consol. L.) § 176. *Cf.* 12A Purdon's Pa. Stats. Ann. [Uniform Commercial Code] §§ 8-103, 8-204; P. L. 3, §§ 8-103, 8-204 (1953, *eff.* 7/1/54). *See Bubbis* v. *Duffy & Bros., Inc.*, 14 Pa. D. & C. 281 (C. P., Phila., 1930, *per* ALESSANDRONI, *J.*); *see also French* v. *Harding*, 235 Pa. 79, 83 A. 586 (1912, *p.c.*).

[101] *Cf. Schmitt* v. *Kulamer*, 267 Pa. 1, 110 A. 169 (1920, *per* KEPHART, *J.*); *Pullman* v. *Upton*, 96 U. S. 328 (1878, *per* STRONG, *J.*); *Sigua Iron Co.* v. *Brozen*, 171 N. Y. 488, 64 N. E. 194 (1902, *per* MARTIN, *J.*).

[102] *Cf. Sproul* v. *Standard Plate Glass Co.*, 201 Pa. 103, 50 A. 1003 (1902, *per* MITCHELL, *J.*); *Fidelity & Dep. Co. of Md.* v. *Hunt*, 107 F. 2d 43 (3d Cir., 1939, *per* CLARK, *J.*).

The foregoing legislation, and the local judicial interpretation thereof, manifest a clear and fair policy in the Pennsylvania law of corporations. A stockholder of record is entitled to an opportunity of redemption (so to speak) before his shares are cancelled or forfeited. Lack of consideration for shares establishes a contract liability to the issuer-corporation, and a lien on the shares to secure that liability. Notwithstanding the constitutional language that the shares are "void" for lack of consideration, the issuer-corporation must exhaust its rights and remedies as creditor and lienholder before it can look to the forfeiture contemplated by the Constitution. The stockholder does not litigate liability to the corporation for the consideration unpaid on his shares, at peril of losing his shares if the consideration is held unpaid. "[T]he shares shall be *forfeited* to the corporation" *only* "*If* no bidder can be had to pay the amount due on the shares, [*and*] *if* the amount is not collected by an action at law * * *." [103]

The stockholder's right of redemption is valuable in a rising market, as here. Management, by a selective call and lawsuit (or appeal), cannot forfeit stock to the issuer (and indirectly to the other stockholders) for lack of prepayment.

(c) The issuer-corporation has the option either to sue the stockholder for the unpaid subscription price, or to foreclose on the shares.[104] The Debtor chose the former course. The Chapter X summary proceedings afforded the Debtor the same opportunity as a local action to obtain the relief prescribed by Pennsylvania law, *viz.*: assessment, prerequisite to forfeiture of shares. The Debtor could—and did—sue *all* the stock-claimants (who had all appeared generally) for the subscription prices or consideration allegedly owed and unpaid by each of them to Nazareth for the outstanding shares of record. In fact, the Debtor objected to allowance

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[103] Pa. Bus. Corp. L. § 605 (*supra*, n. 97).

[104] *Penn-Allen Broadcasting Co. v. Taylor*, 389 Pa. 490, 133 A. 2d 528 (1957, *per* MUSMANNO, *J.*); *Guarantee Title & Trust Co. v. Dilworth Coal Co.*, 235 Pa. 594, 84 A. 516 (1912, *per* BROWN, *J.*).

of all stock-claims, and asked cancellation of all the outstanding Nazareth shares; in the alternative, the Debtor counterclaimed against all 36 stock-claimants for personal judgment for the subscription price of any shares judicially validated, at $1,000 per share (R. 243). The Debtor undertook no proceedings toward forechosure or sale of any of the outstanding stock. For that matter, the Debtor never issued a call; the counterclaims were the first and only notice that subscriptions were unpaid.

Stockholders' liability to the issuer-corporation (or its creditors or their representatives) on unpaid stock subscriptions, is altogether governed by the law of the corporation's domicile.[105] Under Pennsylvania law, the stockholder's *prima facie* case is his stock certificate in regular form. The issuer-corporation bears the *burden of proof*—including the risk of persuasion—of lack of consideration for outstanding shares, and the personal liability therefor owed by the stockholder.[106] "Procedural" matters incident to assessment, if "outcome-determinative" (*e.g.*, statutes of limitation), are part of the "substantive" law of stockholder liability; indeed, they were decisive in bankruptcy proceedings even before *Erie*.[107] Burden of proof is "substantive," too.[108]

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[105] *Harrigan* v. *Bergdoll*, 270 U. S. 560 (1926, *per* BRANDEIS, *J.*); *see* 4 *Collier on Bankruptcy* (14th ed.) ¶ 70.29[2].

[106] *Schmidt* v. *Paul*, 377 Pa. 377, 105 A. 2d 118 (1954, *per* STEARNE, *J.*).

[107] *Harrigan* v. *Bergdoll*, *supra*, n. 105; *see Russell* v. *Todd*, 309 U. S. 280 (1940, *per* STONE, *J.*); *Christopher* v. *Brusselback*, 302 U. S. 500 (1938, *per* STONE, *J.*).

[108] *Cities Serv. Oil Co.* v. *Dunlap*, 308 U. S. 208 (1939, *per* MCREYNOLDS, *J.*) (*diversity*); *Palmer* v. *Hoffman*, 318 U. S. 109, *at* 116 (1943, *per* DOUGLAS, *J.*) (*diversity*); *Garrett* v. *Moore-McCormack Co., Inc.*, 317 U. S. 239 (1942, *per* BLACK, *J.*) (*Jones Act case in state forum*). *See* 1A Moore's Fed. Prac. 2d ed.) ¶ 0.314; 5 *Id.* ¶ 43.08; 3 Collier on Bankruptcy (14th ed.) ¶ 57.13, 57.18[5]; 6 *Id.* ¶ 9.04.

The Debtor proved nothing. Neither Court below placed a valuation on the Market, nor fixed subscription prices, nor ascertained the balances supposedly unpaid by any of the stock-claimants.[109] No shares of stock were validated—only "interests" in Nazareth, and "proportions." (R. 591, 593) The "investments" allowed aggregate $145,987.34 (R. 594-5, 598); additional shares of stock are within the 200-share authorized limit. Ultimately, what the decisions below have found and concluded on the subject, is: "The Market property is sufficient to support a valid stock issue to those entitled thereto." (R. 592)

If Nazareth were insolvent, this record would afford no basis for a money judgment for the benefit of creditors against the aggrieved stock-claimants for unpaid stock subscriptions. Nazareth is solvent; neither does the record afford any basis for a money judgment for the benefit of Nazareth or any of its stockholders against the aggrieved stock-claimants for unpaid stock subscriptions. Mutuality is essential to the stock-subscription contract.[110] Absent ascertained shareholder liability, Nazareth shares cannot be forfeited.

4. Res judicata *bars assessment and stock cancellation.*

(a) The District Court denied the Debtor's counterclaims against all 36 stock-claimants in No. 27000, and, overruling the Debtor's objections to the stock-claims, refused to cancel any Nazareth shares. The Debtor's counterclaims had asked (alternative to cancellation) for assessment of subscription prices against all stock-claimants in the event of judicial

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[109] *See Russell* v. *Todd*, *supra*, n. 107; *Christopher* v. *Brusselback*, *supra*, n. 107; *Harrigan* v. *Bergdoll*, 281 Pa. 186, 126 A. 269 (1926, *per* FRAZER, J.), *aff'd* 270 U. S. 560 (1926, *per* BRANDEIS, J.).

[110] *Penn-Allen Broadcasting Co.* v. *Taylor*, *supra*, n. 104; *see Broderick* v. *Alexander*, 268 N. Y. 306, 197 N. E. 291 (1935, *per* LEHMAN, J.).

validation of any of their respective Nazareth shares (R. 261, 264, 243). So much of the District Court's judgment (denying the Debtor's counterclaims) was *not* appealed from by the Debtor or any other party, nor disturbed by the Court of Appeals. So much of that judgment is now *res judicata*.[111] Assessment, of a liquidated amount due on outstanding shares, is pre-requisite to cancellation or forfeiture of stock. The final judgments below, absent cross-appeal, show *nothing* owed to Nazareth by any of the stock-claimants—including those whose stock-claims were disallowed. Whatever relief the parties may now have, that relief cannot be judicial cancellation of stock.

(b) The Debtor and its stockholders *derivatively* are not "aggrieved parties" in No. 27000.[112] The Debtor's claims to assessment are dead. No money judgment has been rendered against the Debtor in favor of any stock-claimant. The Debtor is not affected by the distribution of its outstanding stock, nor by the identity of its stockholders. The Debtor is a nominal party. No. 27000 is a contest among the stock-claimants themselves.

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[111] *U. S.* v. *American Ry. Exp. Co.*, 265 U. S. 425 (1924, *per* BRANDEIS, *J.*); *Morley Constr. Co.* v. *Maryland Cas. Co.*, 300 U. S. 185 (1937, *per* CARDOZO, *J.*). *See* 7 *Moore's Fed. Prac.* 2d ed. ¶ 72.05. *See also Angel* v. *Bullington*, 330 U. S. 183 (1947, *per* FRANKFURTER, *J.*).

[112] *City of Tampasas* v. *Bell*, 180 U. S. 276 (1901, *per* MCKENNA, *J.*); *U. S. ex rel. La.* v. *Jack*, 244 U. S. 397 (1917, *per* CLARKE, *J.*)

C. The "general federal equity" invoked, and the purchase-money resulting trust impressed, by the Court of Appeals, violate both federal and state rules of decision.

1. *The overissued Nazareth shares are void.*

The Nazareth articles of incorporation authorize a total issue of 200 shares of stock. Any shares issued in excess of 200, are void. This is an absolute mandate of Pennsylvania law.[115] There is little authority for express ratification by stockholders,[116] and none for estoppel.

Here, the Debtor's outstanding stock of at least 262 shares must be judicially reduced to no more than 200 shares. That is what No. 27000 is all about—and bankruptcy has nothing to do with it.

(a) The overissue is identified by the court as a matter of fact, by an arithmetical or mechanical cut-off at the limit of the number of authorized shares; the overissue is then voided as a matter of law. The law on overissue, largely judge-made, developed mostly in the late 1800s, prior to

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[115] *Jutte* v. *Hutchinson*, 189 Pa. 218, 42 A. 123 (1899), *per* DEAN, *J.*; Mt. Holly Paper Co.'s *Appeal*, 99 Pa. 513 (1882), *per*, SHARSWOOD, *C. J.*; Wright's *Appeal*, 99 Pa. 425 (1882), *per* PAXON, *J.*; *Now codified by* 12A Purdon's Pa. Stats. Ann. [Uniform Commercial Code] § 8-104; P. L. 3, § 8-104 (1953, *eff.* 7/1/54), *amended* P. L. 1023, § 8 (1959). *See* U. C. C. *Comment* thereto: "1. The universally recognized prohibition against overissue is here adopted * * *." *See also* Pa. Const., Art. XVI, § 7 (1874, 1956).

[116] *But see* Jeanes' *Appeal*, 116 Pa. 573 (1887), *per* GREEN, *J.*; Kisterbock's *Appeal*, 127 Pa. 601, 18 A. 381 (1889), *per* GREEN, *J.*; *Willis* v. *Phila. & Darby R. R.*, 13 Phila. 33, 6 W. N. C. 461 (C. P. Phila., 1879), *per* HARE, *P. J.*; *New York & N. H. R. R.* v. *Schuyler*, 34 N. Y. 30, *at* 55-6 (1865), *per* DAVIS, *J.* *See also* Pa. Bus. Corp. L. § 320(a); 15 Purdon's Pa. Stats. Ann. § 2852-320(a); P. L. 364, Art. III, § 320 (1933), *added* P. L. 698, § 1 (1939), *amended* P. L. 711, § 1 (1957).

enactment of the Uniform Stock Transfer Act ("USTA") in Pennsylvania in 1911 [117] and in New York in 1913.[118] The cases indicate that the corporate books determined "title" to shares, and thereby the identification of the overissue. No cases have been found where the holder of an overissue sued the holder of valid shares, claiming superior equities: the issuer-corporation seems always to have been the adversary. Now USTA establishes title to stock by ownership of the certificates, not by the corporate books.[119] The rights of the stock-claimants *vis-a-vis* Nazareth are not necessarily the same as their rights *inter se*.

(b) In the usual situation (as in *Nazareth*), the culprit responsible for the overissue is a corporate agent; he, not the corporation, has collected the defrauded holder's price (on a sale) or loan (on a pledge); at the time of exposure, the culprit is judgment-proof. If the culprit had been a stockholder himself, his capital account would have been charged with the shares he sold, *pro tanto*, on a first-in-first-out basis, to the extent of his own valid shares, determined according to the "perfection" of legal title to the shares on the corporate books.[120] When his own shares were exhausted, the culprit was simply selling what he did not own.

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[117] 15 Purdon's Pa. Stats. Ann. §§ 301 *et seq.*; P. L. 126, §§ 1 *et seq.* (1911, *eff.* 1/1/12) (*repealed* 1954).

[118] N. Y. Pers. Prop. L. (40 McKinney's N. Y. Consol. L.) §§ 162 *et seq.* (*eff.* 9/1/13); L. 1913, c. 600; *renumbered by* L. 1939, c. 76, § 4.

[119] *Soltz* v. *Exhibitors Svc. Co.*, 334 Pa. 211, at 215, 5 A. 2d 899 (1939, *per* LINN, *J.*).

[120] *See, e.g., New York & N. H. R. R.* v. *Schuyler*, 34 N. Y. 30 (1865, *per* DAVIS, *J.*); *Moores* v. *Citizens Nat. Bank*, 111 U. S. 156 (1884, *per* GRAY, *J.*).

and what he had no authority to sell for his corporate principal.

To shift his loss, the holder of the void overissue turns to the culprit's principal, the issuer-corporation. The holder's remedy cannot be validation of the void overissue, nor restitution of a purchase price or loan which the corporation never received. So the holder seeks damages. He claims a better title to the stock than the seller-culprit's title, because negotiation of the stock certificate cut off equities and defenses against the culprit, and/or because the corporation is estopped from asserting the invalidity of the overissued shares (as to liability, not the remedy). The estoppel depends on the faithless agent's *apparent* authority to issue or sell the overissued stock, and the corporation's negligence in sanctioning that appearance. (There can be no *actual* authority to overissue stock.)

All this is essentially the law of principal-and-agent. The cause of action by the holder of a void overissue, is substantially the same as the cause of action *for damages* by a holder of shares void for lack of consideration to the issuer-corporation. In either case, where the issuer-corporation did not in fact receive consideration for the shares (or any other benefit), and where the defrauded holder seeks damages, the holder's proof of negligence or estoppel as against the corporation requires much more than mere proof of payment to the agent. The principles of law were stated and applied years ago in a line of classic cases on the subject, decided in Pennsylvania and in other jurisdictions with

similar law.[121] Instructive, too, is a cognate line of cases where corporations (or creditors of insolvent corporations) sued to collect stock subscription prices, and met the defense that the shares were void for overissue or lack of consideration, and therefore not assessable.[122]

Without expatiating on the niceties, the following elementary principles are dispositive in *Nazareth*:

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[121] *People's Bank* v. *Kurtz*, 99 Pa. 344 (1882, *per* SHARSWOOD, C. J.); Wright's *Appeal*, 99 Pa. 425 (1882, *per* PAXON, J.); Mt. Holly Paper Co.'s *Appeal*, 99 Pa. 513 (1882, *per* SHARSWOOD, C. J.); Jeanes' *Appeal*, 116 Pa. 573 (1887, *per* GREEN, J.); Kisterbock's *Appeal*, 127 Pa. 601, 18 A. 381 (1889, *per* GREEN, J.); *Dollar Savings Fund & Tr. Co.* v. *Pittsburgh Plate Glass Co.*, 213 Pa. 307, 62 A. 916 (1906, *p.c.*); *Bonini* v. *Family Theatre Corp.*, 327 Pa. 273, 194 A. 498 (1937, *per* MAXEY, J.); *New York & N. H. R. R.* v. *Schuyler*, 34 N. Y. 30 (1865, *per* DAVIS, J.); *Titus* v. *Great Western Tnpk. Rd.*, 61 N. Y. 237 (1874, *per* LOTT, Ch. C.); *Fifth Ave. Bank* v. *42d St. & Grand St. Ferry R. R. Co.*, 137 N. Y. 231, 33 N. E. 378 (1893, *per* MAYNARD, J.); *Manhattan L. Ins. Co.* v. *42d St. & Grand St. Ferry R. R. Co.*, 139 N. Y. 146, 34 N. E. 776 (1893, *per* MAYNARD, J.); *Hellman* v. *42d St. & Grand St. Ferry R. R. Co.*, 74 Hun 529, 26 N. Y. S. 553 (1st Dept., 1893, *per* VAN BRUNT, P. J.), *aff'd* 148 N. Y. 727, 42 N. E. 723 (1895, *p.c.*); *Mutual L. Ins. Co.* v. *42d St. & Grand St. Ferry R. R. Co.*, 74 Hun 505, 26 N. Y. S. 545 (1st Dept., 1893, *per* VAN BRUNT, P. J.); *Knox* v. *Eden Musee American Co., Ltd.*, 148 N. Y. 441, 92 N. E. 988 (1896, *per* ANDREWS, C. J.); *Jarvis* v. *Manhattan Beach Co.*, 148 N. Y. 652, 43 N. E. 68 (1896, *per* O'BRIEN, J.); *Hudson Tr. Co.* v. *American Linseed Co.*, 232 N. Y. 350, 134 N. E. 178 (1922, *per* HOGAN, J.); *Ehrich* v. *Guaranty Tr. Co.*, 194 A. D. 658, 186 N. Y. S. 103 (1st Dept., 1921, *per* SMITH, J.), *aff'd* 222 N. Y. 673, 119 N. E. 1036 (1922, *p.c.*); *Allen* v. *So. Boston R. Co.*, 150 Mass. 220, 22 N. E. 917 (1889, *per* FIELD, J.); *Craft* v. *So. Boston R. Co.*, 150 Mass. 200, 207, 22 N. E. 917 (1889, *per* FIELD, J.); *Farrington* v. *So. Boston R. Co.*, 150 Mass. 406, 23 N. E. 109 (1890, *per* FIELD, J.); *Smith* v. *Worcester & Southbridge St. Ry. Co.*, 224 Mass. 564, 113 N. E. 462 (1916, *per* LORING, J.); *Moores* v. *Citizens' Nat. Bank*, 111 U. S. 156 (1884, *per* GRAY, J.).

[122] *E.g.*, *Chubb* v. *Upton*, 95 U. S. 665 (1877, *per* HUNT, J.); *Pullman* v. *Upton*, 96 U. S. 328 (1878, *per* STRONG, J.); *Scoville* v. *Thayer*, 105 U. S. 143 (1881, *per* WOODS, J.); *Handley* v. *Stutz*, 139 U. S. 417 (1891, *per* BROWN, J.). *See* 4 Collier on Bankruptcy (14th ed.) ¶ 70.29[2].

> "* * * an agent cannot bind his principal, even in matters touching his agency, where he is known to be acting for himself, or to have an adverse interest. [Cases cited.]
>
> "The plaintiff in such a case assumes the risk of the agent's disloyalty to his trust, and has no occasion for surprise when he discovers that the agent has served himself more faithfully than his principal." [123]

If the defrauder is the purchaser's own agent *in that transaction*, the agent's knowledge of prior equities will be imputed to the purchaser-principal.[124]

(c) Most or all of the 36 stock-claimants in No. 27000 have not made, and cannot make, proof of estoppel or negligence *vis-à-vis* Nazareth.

In dealing in the Nazareth stock, Malakoff openly professed to own all the stock himself, and to be the managing agent of the issuer-corporation. Until delivery of the stock certificates, most of the stock-claimants held, as *quid pro quo* for their advances, nothing but Malakoff's letter-receipts, most of which stated:

> "* * * all of the authorized stock * * * has been issued to me. * * * I may cause to be issued to you *n* shares of my present stockholdings. * * * the method of operation is to remain solely in my hands. * * *" (R. 186-7)

Malakoff's letter-receipts, by making full disclosure of his self-dealing in the Nazareth stock, conclusively put the

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[123] *Manhattan L. Ins. Co.* v. *42d St. & Grand St. Ferry R. R. Co.*, 139 N. Y. 146, *at* 151-2, 34 N. E. 776 (1893, *per* MAYNARD, *J.*).

[124] *Curtis, Collins, & Holbrook Co.* v. *U. S.*, 262 U. S. 215 (1923, *per* TAFT, *C. J.*) (quoted *at* pp. 87-88, *supra*); *Munroe* v. *Harriman*, 85 F. 2d 493 (2d Cir., 1936, *per* SWAN, *J.*), *cert. den.* 299 U. S. 601 (1936); *Holden* v. *N. Y. & Erie Bank*, 72 N. Y. 286 (1878, *per* FOLGER, *J.*); *Scouton* v. *Stony Brook Lumber Co.*, 261 Pa. 241, 104 A. 548 (1918, *per* WALLING, *J.*).

stock-claimants "on notice."[125] Those writings bind the stock-claimants as against Nazareth, irrespective of any fraud committed by Malakoff *qua* agent of Nazareth.[126] Near the end, stock certificates delivered to a handful of investors contemporaneously with their payments to Malakoff, appeared as if original issues; Malakoff had not first negotiated to those purchasers stock certificates in his name and ostensibly genuine. Those stock-claimants, too, were paying and trusting Malakoff individually, and were legally "on notice."[127] The stock-claimants could acquire no better title than Malakoff's to stock which Malakoff took *illegally* from Nazareth in his own name and transferred.

Neither could those stock-claimants prevail on the contention that they had undertaken to buy an original issue from Nazareth, and that they had dealt with Malakoff *qua* agent, not individually. Every stock-claimant paid Malakoff—not Nazareth—for his stock. Payment for an original issue should have gone to Nazareth.[128] Ultimately, what distinguishes *Nazareth* from *all* the other reported cases on fraudulent stock issues, is the absence of stock certificates upon which the stock-claimants could stake their putative reliance on Malakoff's misrepresentations of authority and genuineness.[129] Without stock certificates, most of the stock-

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[125] *Northridge Co-op. Sec. No. 1, Inc.* v. *32nd Ave. Constr. Corp.*, 2 N. Y. 2d 514, *at* 527-8, 161 N. Y. S. 2d 404 (1957, *per* VAN VOORHIS, *J.*); *Danann Realty Corp.* v. *Harris*, 5 N. Y. 2d 317, 184 N. Y. S. 2d 599 (1959, *per* BURKE, *J.*); *Ernst, Iron Works, Inc.* v. *Duralith Corp.*, 270 N. Y. 165, 200 N. E. 683 (1936, *per* FINCH, *J.*).

[126] *Wittenberg* v. *Robinov*, 9 N. Y. 2d 261, 213 N. Y. S. 2d 430 (1961, *per* FROESSEL, *J.*).

[127] *Moores* v. *Citizens' Nat. Bank*, 111 U. S. 156 (1884, *per* GRAY, *J.*).

[128] *See Fehr* v. *Campbell*, 288 Pa. 549, 137 A. 113 (1927, *per* MOSCHZISKER, *C. J.*); *Hartzell* v. *Ebbvale Mining Co.*, 239 Pa. 602, 86 A. 1093 (1913, *per* ELKIN, *J.*); *Martin* v. *Inter-State Lumber Co.*, 263 Pa. 248, 103 A. 613 (1918, *p.c.*).

[129] *Cf. cases cited supra*, n. 121. *Compare Baldwin* v. *Childs*, 249 N. Y. 212, 163 N. E. 737 (1928, *per* CARDOZO, *C. J.*) *with Barnard* v. *Campbell*, 55 N. Y. 456, *rearg.* 58 N. Y. 73 (1874, *per* ALLEN, *J.*) (*bills of lading*).

claimants here have nothing to rely on, as to Nazareth's liability for Malakoff's over-sales.

(d) Assuming (*arguendo*) that any of the stock-claimants in No. 27000 could sustain a claim of estoppel or negligence as against Nazareth with respect to purchase of an overissue: If successful, they would be entitled to damages in the amount of their purchase prices or loans advanced to Malakoff, though the Debtor might be ordered to go into the open market to buy other valid stock, if "reasonably available for purchase", to substitute for the void overissue in innocent hands.[130]

This law on overissue, and particularly the restricted remedy of the defrauded holder entitled to shift his loss to the issuer-corporation, offers a peculiar protection to the earlier investors or stockholders. Unissued stock is not a corporate asset. The issuance of new stock without consideration to the issuer-corporation, whether or not an overissue, does not, *per se*, affect the corporation's assets or liabilities. On the corporate balance sheet, only the capital account is affected; but the net worth is unchanged. The primary wrong in a fraudulent stock issuance, is the over-division and *dilution* of the stockholders' proportionate interests in the corporation's net worth and control, without fair contribution to the corporation by the latecomers. The stockholders of the solvent corporation are injured *directly*; the corporation as an entity, and the stockholders *derivatively*, suffer no wrong.[131]

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[130] 12A Purdon's Pa. Stats. Ann. [Uniform Commercial Code] § 8-104; P. L. 3, § 8-104 (1953, *eff.* 7/1/54), *as amended*, P. L. 1023, § 8 (1959). *See Prince* v. *Childs Co.*, 23 F. 2d 605, at 608 (2d Cir., 1928, *per* A. N. HAND, *J.*).

[131] *Christensen* v. *Eno*, 106 N. Y. 97, 12 N. E. 648 (1887, *per* ANDREWS, *J.*); *Frank Gilbert Paper Co.* v. *Prankard*, 204 A. D. 83, 198 N. Y. S. 25 (3d Dept., 1923, *per* VAN KIRK, *J.*); *Kimmel Sales Corp.* v. *Lauster*, 167 M. 514, 4 N. Y. S. 2d 88 (Sup., Monroe, 1938, *per* VAN VOORHIS, *J.*).

If an insider commits a fraud by selling an overissue for which the corporation—and the stockholders derivatively—are vicariously liable in damages, the absolute invalidation of an overissue effectually gives those stockholders the option to pay money damages out of the corporation, and thereby to avoid dilution of their stock interests. In a rising market (as here), this enhances the valid shares, and may be a poor return to the defrauded holder—notwithstanding that (as here) the earlier investors could not themselves have sustained such an estoppel as against their corporation, and notwithstanding that those earlier investors (derivatively) were themselves negligent as against the innocent latecomers.

(e) To the District Judge and the Examiner, application of the law on overissue seemed arbitrary and inequitable. They avoided such application by the simple omission of certain crucial findings of fact: no findings were made as to *constructive notice* of Malakoff's wrongdoing, and no findings were made as to *identification of the overissue*. The Examiner stated affirmatively that such identification was impossible:

> "143. To hold any of the shares claimed by the claimants-stockholders herein void on account of over-issuance, however, this Court must determine whose shares were and are the over-issued shares. The fact is that no rational or just basis appears in the record for any such determination. * * * The order in which Malakoff made out certificates to the investors and the numbers assigned to the certificates, as well as the dates when he issued such certificates, were purely fortuitous or arbitrary. * * *" (R. 210)

That finding, implicitly adopted by the District Judge, is not "clearly erroneous,"[132] and has not been disturbed

[132] Rule 52(a), Fed. Rules of Civ. Proc., *f.* 28 U. S. C. § 2072

by the Court of Appeals, nor challenged by any of the parties. It is supported by the lack of correlation between the times of the stockholders' advances to Malakoff, the times of Malakoff's promises of "shares" to the stock-claimants, and the dates and numbers on the stock certificates (R. 210-211). Moreover, the Margolis Group, in No. 26962, claims 51 shares, represented by stock certificates scattered among the certificates for the 262 shares claimed by the 36 stock-claimants in No. 27000. Absent consolidation of all 41 stock-claims, no definitive identification of the overissue could possibly be made.

(f) The foregoing left the Courts below with these problems (*inter alia*):

(i) The Nazareth shares had to be judicially reduced to no more than 200 total. Both Courts below could not—and would not—eliminate the overissue by arithmetic alone.

(ii) A reduction of Nazareth shares *below* 200 total, necessarily would rest on a ground other than overissue; for the overissue left 200 shares presumptively valid. The only other ground for voiding corporate shares was lack of consideration to the issuer-corporation. However, assessment of the subscription price (the Debtor's alternative counter-claim against the stock-claimants) would not resolve the overissue.

(iii) All the stock-claimants, *vis-à-vis* Nazareth, were on notice of the infirmities in Malakoff's title to stock, and were no more "good-faith purchasers" than the few who had not advanced contemporaneous consideration to Malakoff. Therefore, any classification of stock-claimants necessarily would depend on a legal ground other than the relative positions of the stock-claimants *vis-à-vis* Nazareth.

2. *The purchase-money resulting trust impressed by the Court of Appeals is barred by applicable state rules of decision.*

Having cancelled all the outstanding Nazareth stock (despite the Pennsylvania law), the Court of Appeals then impressed a purchase-money resulting trust. What had begun as a distribution of the *Debtor's stock* in a reorganization of the Debtor, finished as a distribution of *Malakoff's assets* without Malakoff. Judge Moore wrote:

> "* * * The sellers (Philadelphia group) have been paid for that [Market] property by Malakoff. Malakoff in turn obtained the money *for this purpose* from those who thought that they were to receive an interest in the Nazareth Market. Malakoff as the promoter must be regarded as a *trustee*, fiduciary, *agent*, promoter or syndicator (the terminology is unimportant—the facts create the rights) *for those who gave him their funds for investment in the project.* They should in equity receive that for which they paid." (R. 592-3; *emphasis supplied.*)

Applicable state law bars such a remedy. The rules of decision in equity in both New York and Pennsylvania, preclude the resulting trust impressed below, irrespective of "terminology."

(a) In *New York*, the purchase-money resulting trust has been explicitly abolished by statute,[133] incident to a codification of the law of trusts.[134]

The resulting trust, as a form or device, has been found dispensable. It served either to presume intent or to avoid and remedy fraud. Those purposes are served by the trusts that remain in New York: the *express trust*, subject to the

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[133] N. Y. Real Prop. L. (L. 1909, c. 52) (49 McKinney's N. Y. Consol. L.) § 94.

[134] N. Y. Real Prop. L. § 91 (*supra*, n. 133).

statute of frauds; and the *constructive trust*, or judicially "implied" or "fraud-rectifying" trust.[135]

An express trust or a constructive trust in *Nazareth* would have allowed the prevailing stock-claimants *precisely* "that for which they paid" (R. 593) — *e.g.*, in Weinstein's case, $^{7}/_{200}$, or 3.5%, under his letter-receipt from Malakoff, instead of 4.79% as awarded to him by the Court of Appeals.

(b) In *Pennsylvania*, resulting trusts, though not abolished, have been severely curtailed by statute and case-law. A purchase-money resulting trust could operate here in favor of an "investor" *only* if his advances had been made to Malakoff *before* Malakoff had paid the purchase price of the realty to the Philadelphia Group. *Subsequent* advances, even if used for improvement of the realty or for satisfaction of liens on the realty, would at most give the "investor" an equitable lien for recovery of his "investment" but *not* equitable ownership of the realty.[136]

Musselman v. Myers,[137] decided by the Pennsylvania Supreme Court in 1913, is particularly apposite to *Nazareth*.

> "* * * about February 22d, 1911, [plaintiff] agreed with * * * Myers * * * to subscribe the sum of $2,500 to the capital stock of a proposed corporation, which was about to be formed with a capital of $20,000 for the purpose of purchasing the real estate * * *; that

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[135] *Fraze Realty Co., Inc.* v. *Natanson*, 261 N. Y. 396, 185 N. E. 679 (1933, *per* KELLOGG, *J.*); *In re* Cohen's Estate, 137 N. Y. S. 2d 300 (Sup., N. Y., 1954, *per* WALTER, *J.*), *aff'd* 285 A. D. 1119, 141 N. Y. S. 2d 819 (1st Dept., 1955), *aff'd* 309 N. Y. 935, 132 N. E. 2d 311 (1955).

[136] *Musselman* v. *Myers*, 240 Pa. 5, 87 A. 425 (1913, *per* ?); *Farmers Trust Co.* v. *Bevis*, 331 Pa. 89, 200 A. 54 (1938, *per* DREW, *J.*); *Majors* v. *Majors*, 349 Pa. 334, 37 A. 2d 528 (1944, *per* HUGHES, *J.*); *Accord: Olcott* v. *Bynum*, 84 U. S. 44 (1873, *per* SWAYNE, *J.*).

[137] *Supra*, n. 136.

on February 24th, 1911, at the direction of Myers, plaintiff paid the amount of his said subscription to * * * Sherwood as the agent and for the account of Myers; that at the said time Myers was under agreement with * * * the owners of record of the said land, for the purchase thereof, and had paid them on account of said purchase about the sum of $500; that the purchase price named in the said agreement was $9,600; that Myers completed the purchase of the land on March 3d, 1911, by paying to the [owners] the further sum of $2,700 (which included the sum of $2,500 received from the plaintiff) and having executed * * * a purchase money mortgage for $6,400; * * *.

"* * * It appears, therefore, that Myers had acquired an equitable interest in the land before the receipt of the plaintiff's money, and that the said subscription was employed only in making a subsequent payment on account of the price. No resulting trust could arise in favor of the plaintiff under these circumstances.

"'A resulting trust is raised only from fraud in obtaining the title, or from payment of the purchase money when the title is acquired. Payment of the purchase money subsequently is not sufficient to raise a legal implication of a trust as all the authorities show.': [Pa. cases cited.]

"The amount of the plaintiff's subscription was not in the hands of Myers at the time he acquired his inceptive equitable interest in the land, which was the inception of the title to it, by the payment of the $500 hand money, nor does it appear * * * that at that time Myers expected to receive it and relied upon it for funds with which to make the additional cash payments which he afterward made upon the account of the purchase price." * * *

> "The plaintiff appears to be entitled to have the stock for which he subscribed or the return of his money. We think that his remedy is a suit at law. * * *" [138]

In *Nazareth*, Malakoff is said to have paid the Philadelphia Group a total of $77,010.81, and to have received a total of $79,025 from "investors", all *before* February 15, 1952 (R. 589). Yet, "investments" aggregating $145,987.34 —almost half advanced *after* that date—have been allowed (R. 594-5, 598). Under Pennsylvania law, those later "investors" *cannot* be *cestuis* of a purchase-money resulting trust. Indeed, neither could most of the "investments" made *before* February 15, 1952, qualify for a resulting-trust interest. Malakoff had a ¼ interest in the Market from the time of its purchase by the Philadelphia Group in March and April of 1951. He had advanced $17,489 to them not later than May 8, 1951, and, through them, at least $12,489 to the sellers of the Market. Of that $17,489, $8,000 had been advanced by Kanter, Samet, and G. S. Klein; Malakoff promised them participating "shares" in Malakoff's "interest" in the venture, and their $8,000 has been traced by explicit findings. In July of 1951, Malakoff contracted with the Philadelphia Group to buy—and he then acquired an *equitable* interest in—the *entire* Market property. No "investments" by other stock-claimants were found to have been made until August of 1951 and thereafter; nor is there any evidence or finding that any of the prevailing stock-claimants, other than Kanter, Samet, and G. S. Klein, had any relationship with Malakoff before or during July of 1951 to establish Malakoff's "reliance" on them for the balance of the price he owed to the Philadelphia Group (R. 588-9, 230-1, 51-2, 56-7). The impression of a purchase-money resulting trust here would leave Kanter, Samet, and G. S. Klein (the April "investors") as the sole *owners* of the Market.

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[138] *Musselman v. Myers*, *supra*, n. 136, 240 Pa. *at* 6-9.

Neither can the later "investors" qualify as "good-faith purchasers" to perfect an equitable interest in the Market *vis-à-vis* prior *cestuis* of the purchase-money resulting trust.[139] In purchasing the Market, Malakoff is now said to have acted (as agent or trustee) for *all* the "investors" *in the purchase transactions*, and not for himself, for Nazareth, or for the sellers (R. 592-3). Therefore, the later "investors" (certainly those who made their advances to Malakoff after February 15, 1952) are charged with *notice* of Malakoff's wrongdoing in selling the true *cestuis'* interests in the realty for Malakoff's own benefit; and the later "investors" cannot be "*bona fide* purchasers" *vis-à-vis* those true *cestuis*.[140]

(c) If the Court of Appeals admitted those later "investors" to participation in the Market because Malakoff was their trustee *ex maleficio*, and if those later "investors" thereby obtained the same standing here as the earlier "investors" for whom Malakoff was supposedly a purchase-money resulting trustee, then the Court of Appeals has converted this corporate reorganization into an *in rem* proceeding to distribute Malakoff's property to anyone with any kind of equitable interest therein. The aggrieved stock-claimants (whose stock-claims were disallowed) then have the same standing as those later "investors." For what the Court of Appeals has characterized as "antecedent indebtedness *or other transactions* with [Malakoff] unrelated to the Nazareth venture *as consideration*" (R. 594; *emphasis supplied*), may also have been trust funds in Malakoff's hands, and may also have raised equitable interests in the Market in their favor. (*See, e.g.*, as to the Dancigers' consideration, R. 595, 148-9.) The Court of Appeals has not distinguished between true

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[139] 21 Purdon's Pa. Stats. Ann. § 601; P. L. 425, § 1 (1901).

[140] *Curtis, Collins, & Holbrook Co.* v. *U. S.*, 262 U. S. 215 (1923, *per* TAFT, C. J.) (*quoted at* pp. 87-88, *supra*); *Munroe* v. *Harriman*, 85 F. 2d 493 (2d Cir., 1936, *per* SWAN, J.), *cert. den.* 299 U. S. 601 (1936); *Holden* v. *N. Y. & Erie Bank*, 72 N. Y. 286 (1878, *per* FOLGER, J.); *Scouton* v. *Stony Brook Lumber Co.*, 261 Pa. 241, 104 A. 548 (1918, *per* WALLING, J.).

"indebtedness" and "trust funds" with respect to the aggrieved stock-claimants; and all semblance of "tracing" and "notice" has been abandoned as to the later "investors." Indeed, the Court of Appeals' theory would entitle Malakoff's creditors and *cestuis at large* to the same opportunity as the later "investors" here to prove equitable interests in the Nazareth Market.[141]

Thus, the peculiar resulting trust impressed below—advocated by Weinstein and Fried in their joint briefs below, and barred by both New York and Pennsylvania law—is the sole "equitable" device which can penalize 6 stock-claimants, while enriching 30 others, for Malakoff's individual wrongdoing—of which all 36 have been found equally innocent.

3. *The classification of stock-claimants by the Court of Appeals, is arbitrary and unreasonable in terms and in application, and depends upon the prohibited setting aside of District Court findings of fact not "clearly erroneous."*

The major errors committed by the Court of Appeals in No. 27000, and relating to the Question Presented to this Court, have been discussed above. Of the many additional errors below, a few require notation to demonstrate the need for complete reversal of the Court of Appeals' decision, and complete rejection of its rationale.

(a) *Unreasonable classification:* The Court of Appeals decided the stock-claims by classifying all 36 stock-claimants in No. 27000 into two categories, and then excluding some of them from participation in Nazareth stock. The classification is unreasonable on its face, and is arbitrary in its application to the particular stock-claimants.

> "As to the stock claimants, with few exceptions they fall into two distinct categories: (1) those investors who paid for a participation in the Nazareth Market by cash, check or *credit*, and (2) those who

[141] *See generally* 4 *Collier on Bankruptcy* (14 ed.) ¶¶ 70.25, 70.41.

> did not make any payment but who rely upon *antecedent indebtedness* of Malakoff and other transactions with him unrelated to the Nazareth venture as consideration." (R. 594; *emphasis supplied.*)

This is simply no classification. "Credit" is the correlate of "debt" or "debit"; "credit" must be credit *for* something. "Credit" here is not cash or check. Here, it must mean "credit *for* antecedent indebtedness or investment exchange." It can mean nothing else. This is like saying: Class A contains only odd numbers, and Class B contains only even numbers—but some odd numbers, too. By this system, whim—not reason—dictates whether odd numbers are put into Class A or Class B, and whether stock-claims are put into Class 1 or Class 2.

The Court of Appeals' application of that classification to the particular stock-claims, repeatedly reveals arbitrariness. *E.g.:* The following stock-claimants have been put into the first class ("good"), though some or all of their "consideration" had been found by the District Court to have been moneys *previously* advanced to Malakoff by way of loans or investments, or moneys held by Malakoff as profits or returns of capital on "other transactions with [Malakoff] unrelated to the Nazareth venture": Jerome Fried, $2,000 "profit" (R. 155-6); H. Lawrence Laupheimer, $2,750 investment exchange (R. 116-7); Gertrude Silver Klein, $2,000 loan and $6,000 investment exchange (R. 67-8); Miriam Klein, $2,150 loan and/or investment exchange (R. 98, 100).[142] Those "credits" are no different in kind from (*e.g.*) Kanter's $4,800 investment exchange in September of 1951, which the District Court *found* to be "valuable equities" and to have been part of the "net fair value of the investment" by Kanter. (R. 232; *see* R. 59-60, 63; *cf.* R. 595).

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[142] "As to these claimants, the findings of the Examiner and the trial court relating to the amounts paid to Malakoff *and the circumstances under which they were paid* are affirmed." (R. 594; *emphasis supplied.*)

(b) *Violation of "clearly erroneous" rule:* In order to impress a purchase-money resulting trust on the Market, the Court of Appeals needed two general *facts* as foundation, *viz.: tracing* of the "investors'" advances to Malakoff into the purchase price of the Market,[143] and *intention* of the prevailing stock-claimants to deal with Malakoff as *their agent* or trustee (not as their seller) in the acquisition of "shares" of the Market or Nazareth.[144] The Court of Appeals found those facts, and thereby set aside the District Court's findings, to the contrary, that there had been *no tracing* of any of the stock-claimants' advances to Malakoff (except those of Kanter, Samet, and G. S. Klein in April of 1951), and *no tracing* of the source of Malakoff's payments of the purchase price to the Philadelphia Group, and that *all* 36 stock-claimants in No. 27000 had *intended* to deal with Malakoff in his *individual* capacity as seller of "shares." Similarly, the Court of Appeals traced the source of Malakoff's "dividends," thus setting aside the District Court's findings to the contrary.

The relevant discrepancies in the *nisi prius* findings and the appellate findings on tracing and intention, are documented in Wolf's Statement of Facts (pp. 22-24, *supra*), and need not be repeated here. What does need to be noted is that *tracing* presumptions and fictions, while useful *vis-à-vis* the wrongdoer, have most doubtful "equity" as to the wrongdoer's *victims inter se*.[145] And what does need to be repeated, is Judge Moore's statement recognizing—but avoiding—the gross inconsistencies in findings of fact above and below as to the stock-claimants' *intent* and Malakoff's *capacity*:

> "Although the findings of fact of the Examiner may be accepted almost in their entirety, his conclu-

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[143] *See Cunningham (Trustee of Ponzi) v. Brown*, 265 U. S. 1 (1924, *per* TAFT, *C. J.*); 4 *Collier on Bankruptcy* (14th ed.) ¶¶ 70.25, 70.41. *N. B.* R. 590, n. 1.

[144] *See Majors v. Majors*, 349 Pa. 334, *at* 338-9, 37 A. 2d 528 (1944, *per* HUGHES, *J.*).

[145] *See Cunningham v. Brown*, *supra*, n. 143.

> sions are at variance with the equitable principles applicable here. The Examiner treated *Malakoff as the owner* and operator of the Debtor and *each claimant as having purchased his interest from Malakoff.* This *erroneous assumption* made it possible for the Examiner to accept the stock claims of all claimants who had received stock from Malakoff on the theory that stock transfers from Malakoff rested upon adequate consideration if the Stock Transfer Acts' definition of 'value' were satisfied. * * * " (R. 53; *emphasis supplied.*)

The Examiner's "treatment" is characterized as an "assumption," and is held "erroneous." But that "assumption" was a finding of fact, or at least rested on underlying and implicit findings of fact as to the many transactions between Malakoff and the 36 stock-claimants in No. 27000. In November of 1961, the Court of Appeals undertook itself, from a cold record, to make 36 findings of fact as to the state of mind of each of 36 persons at various times during a two-year period from March of 1951 to April of 1953, who were dealing with a man (Malakoff) who died in 1955. The District Court had spent 86 days of actual trial in 1958 and 1959—then already five years and more after the events—listening to and looking at more than 50 witnesses (including nearly every stock-claimant), whose aggregate testimony fills almost 10,000 pages of minutes, and who introduced literally hundreds of pages of documentary evidence. Both the District Judge and the Examiner had then *independently* engaged in "pains-taking" review of the evidence, reflected in a 236-page Report by the Examiner and in findings and conclusions by the Judge (R. 590; 492, 245-6). Every shred of documentary evidence—the stock-claimants' checks to Malakoff, the letter-receipts from Malakoff, the dividends from Malakoff, etc.—showed the clear understanding and agreement between Malakoff and every stock-claimant (except Kanter, Gertrude Klein, and Samet) that every stock-claim-

ant of the 36 was buying *stock* Malakoff professed to own himself. The only evidence to the contrary consists of the self-serving testimony of some of the 36 stock-claimants as to their putative conversations with the dead John Malakoff more than five years earlier—evidence of *no* probative value. (*See, e.g.*, the evidence in Weinstein's case, pp. 24-25, *supra*.)

On appeal, the facts of the case are established by the findings of the trial court "unless clearly erroneous":

> "[Rule 52](a) * * * Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. * * * " [146]

This Court crystallized the apposite principles a generation ago.

> "Findings as to the *design, motive and intent* by which men act depend peculiarly upon the credit given to witnesses by those who see and hear them. If defendants' witnesses spoke the truth, the findings are admittedly justified. * * * While, of course, it would be our duty to correct clear error, even in findings of fact, the Government has failed to establish any greater grievance here than it might have in any case where the evidence would support a conclusion either way but where the trial court has decided it to weigh more heavily for the defendants. Such a choice between two permissible views of the weight of evidence is not 'clearly erroneous.' " [147]

The District Court's findings were not "clearly erroneous"; indeed, they were the only reasonable findings of fact

[146] Rule 52(a), Fed. Rules of Civ. Proc., *f.* 28 U. S. C. § 2072.
[147] *U. S.* v. *Yellow Cab Co.*, 338 U. S. 338, *at* 341-2 (1949, *per* JACKSON, *J.*) (*emphasis supplied*).

on the evidence. In substituting its own findings of fact, the Court of Appeals has committed an egregious violation of Rule 52(a) and has acted outside the proper scope of appellate review. Thereby, the Court of Appeals has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

D. The Debtor's 200 authorized shares should be distributed among the 36 stock-claimants in direct proportion to their respective record holdings of 262 shares of stock actually issued in 1953. Thereby, all the stock-claimants, equally innocent of Malakoff's wrongful over-sales, will ratably absorb the dilution in their promised interests in Nazareth.

The realities of *Nazareth* show two simple—and decisive—legal factors. First, the relations among Nazareth, Malakoff, and the 36 stock-claimants were truly *tripartite*. Malakoff expressly undertook to sell to the stock-claimants what he had individually acquired from Nazareth, and what he himself owned. Even if he had said something different, his conflicts of interest with Nazareth, and his misrepresentations to and conflicts of interest with the stock-claimants, would still have made him an individual seller with respect to at least some of the stock-claimants, as a matter of law. For he did not act within the scope of his agency or his trust to anyone in over-selling Nazareth stock to the stock-claimants and in causing Nazareth to overissue stock. Secondly, the only relevant *wrong* committed by Malakoff was his over-sale and overissue of Nazareth shares, which diluted all stock-claimants' interests in Nazareth and thus affected them directly, not derivatively. There was no lack of consideration to Nazareth for issuance of 200 shares (the authorized limit); and even if there were, the remedy would be assessment, not cancellation—which would not cure the overissue.

This litigation could never have come to pass if Malakoff had not misrepresented total sales of 200 shares, and if Nazareth were authorized to issue (say) 400 shares of stock. All 36 stock-claimants were equally innocent of participation in Malakoff's wrongdoing, and all (certainly the earlier "investors") were equally supine in abdicating control of Nazareth to Malakoff. All 36 should share ratably in the loss imposed on them all by Malakoff alone.

The District Court's viewing Nazareth as Malakoff's *alter ego* and/or principal in the stock-sales, and the Court of Appeals' viewing Malakoff as the stock-claimants' agent or trustee in the stock-sales, avoided recognition of the tripartite relationship and the critical wrong by Malakoff, and thereby muddied the record below and yielded two decisions vastly different from each other, yet both gravely erroneous in their own terms, in fact and in law.

The only proper resolution of the 36 stock-claims in No. 27000 in accordance with the unassailable findings of fact by the District Court and the applicable Pennsylvania and New York rules of decision—and a perfectly "equitable" resolution of the controversy among the stock-claimants *inter se*—is the distribution of the entire 200 issued and outstanding Nazareth shares within the authorized limit, to all those 36 stock-claimants, in direct proportion to their respective holdings of the 262 outstanding shares of stock which Malakoff caused Nazareth to issue in 1953.

The relief prayed for by Wolf, differs from the District Court's judgment only with respect to the index of participation by the 36 stock-claimants. The number of shares purchased from Malakoff under the stock-purchase contracts—not the amount of moneys advanced to Malakoff therefor—should determine the ratable participation of the 36 stock-claimants in Nazareth.

1. *The rights of the stock-claimants, inter se, to Nazareth shares, are determined by their respective stock-purchase contracts with Malakoff, not by the amounts of their respective "investments."*

(a) What this Court has said about the Constitutional limitations on Congress in the exercise of the bankruptcy power by legislation, applies as well (*mutatis mutandis*) to the Constitutional limitations on the Chapter X courts in the administration of the legislation implementing the bankruptcy power:

> "*Fourth.* The bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment. Under the bankruptcy power Congress may discharge the debtor's personal obligation, because, unlike the States, it is not prohibited from impairing the obligation of contracts. [Cases cited.] But the effect of the [Frazier-Lemke] Act here complained of is not the discharge of Radford's personal obligation. It is the taking of substantive rights in specific property acquired by the Bank prior to the Act. In order to determine whether rights of that nature have been taken, we must ascertain what the mortgagee's rights were before the passage of the Act. We turn, therefore, first to the law of the State." [149]

What is covered by a lien, is a matter of contract between the parties, in accordance with applicable state law. No less than liens on realty, shares of corporate stock are property, and are likewise determined by contract between the parties, in accordance with applicable state law.[150]

(i) The Bankruptcy Act provides for the trustee's *rejection* of otherwise valid *executory* contracts. Thereby, the

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[149] *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555, at 589-590 (1935, *per* BRANDEIS, J.).

[150] *Schaad* v. *Hotel Easton Co.*, 369 Pa. 486, 87 A. 2d 227 (1952, *per* STERN, J.).

bankrupt's performance is excused, and is replaced by an obligation to compensate in damages; the damages are limited in amount, and the bankrupt's liability therefor is discharged. Only thus may the bankrupt (or his trustee) substitute money for the *future* transfer of the bankrupt's property promised under a valid contract. More than that, is unconstitutional.[151]

(ii) The Bankruptcy Act provides for the trustee's avoidance of otherwise valid *executed* contracts and *past* transfers of the bankrupt's property if—and only if—the bankrupt's transfer was "preferential," *i.e.* (*inter alia*) if the transfer was "perfected" within four months of bankruptcy while the bankrupt was then insolvent (in the bankruptcy sense) and in consideration of "antecedent indebtedness."[152] Here, the last stock certificate issued by Nazareth to any of the 36 stock-claimants in No. 27000, was delivered to the Dancigers on April 28, 1953 (R. 146, 150)—five months before the reorganization petition was filed (on September 28, 1953). Nazareth was not then insolvent in the bankruptcy sense. (Saul General-Examiner's Exh. BY; R. 516, 518, 9587.) Indeed, there is no finding that Malakoff himself was insolvent before June 17, 1953 (R. 57).

(b) Both Courts below have used the stock-claimants' "investments" (variously defined) as the index of judicial distribution of Nazareth shares to the stock-claimants. The Courts have proceeded as if they were distributing in kind the proceeds of a fund of money in which certain stock-claimants were entitled to share ratably. They have presupposed that all the outstanding Nazareth shares were void, and that a share in the fund depended on a contribution of money to that fund or on a damage claim against the prop-

[151] Bankruptcy Act, § 116(1); 11 U. S. C. § 516(1); 52 Stat. 885 (1938); *see* 6 *Collier on Bankruptcy* (14th ed.) ¶¶ 3.23, 3.24, 3.25. *See also Cohen* v. *East Netherland Holding Co.*, 258 F. 2d 14 (2d Cir., 1958, *per* LUMBARD, *J.*), *aff'g* [*sub nom. In re New York Investors Mutual Group, Inc.*] 153 F. S. 772 (S. D. N. Y., 1957, *per* WEINFELD, *J.*).

[152] *See generally* 3 *Collier on Bankruptcy* (14th ed.) ¶ 6002.

erty of a common debtor: "Greater equity will be achieved by calculating the allowed claims in terms of dollars rather than in invalidly issued shares" (R. 593).

(i) The *Debtor* has no interest in the varying prices paid by the stock-claimants to Malakoff for their respective shares. The Debtor is satisfied by its receipt of the Market for all those shares, and is indifferent to the devolution of its shares—or the prices to successive transferees in the open market—once the over-all subscription price is paid for the original issue. Indeed, there may be good business reasons for the corporation itself to sell its own shares in the market at different prices at different times.[153]

(ii) As to the *stock-claimants inter se:* They have all *affirmed* their stock-purchase contracts with Malakoff, by demanding stock, not money. Some have asked damages or restitution in the alternative, in the event that their stock-claim should be denied, *e.g.*, Weinstein (R. 120-1). No one has attempted to rescind.[154] Malakoff varied his prices to the stock-claimants: *e.g.*, $333 per share to Kanter in April of 1951 (R. 58-9); $600 per share to Katzenell, $667 per share to Fried, and $1,000 per share to Weinstein, all in early September, 1951 (R. 178-9, 157, 123). Malakoff represented himself as an individual seller, and he made no promises or representations to any stock-claimant as to the price of shares he had charged or would charge to other stock-claimants. He was emphatic that the "shares" he sold, in fractions of $n/200$, would fix his purchasers' interests in Nazareth, regardless of the form the venture might take.

> "In the course of my management of the Market, I may cause to be issued to you [illegible]00 shares of my present stockholdings. On the other hand, I may

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[153] *See Maguire* v. *Osborne*, 338 Pa. 121, 130 A. 2d 157 (1957, *per* C. J.); *Atlantic Refining Co.* v. *Hodgman*, 13 F. 2d 781 (3d Cir. [Del.], 1926 *per* BUFFINGTON, J.), *cert. den.* 273 U. S. 731 (1926).

[154] *Cf. Cunningham (Trustee of Ponzi)* v. *Brown*, 265 U. S. 1 (1924, *per* TAFT, C. J.); R. 590, n. 1.

> cause the dissolution of the Corporation and arrange for the formation of a limited partnership and your *a shares* will be applied as your contribution with a corresponding *proportionate interest.* * * * " (R. 187; *emphasis supplied.*)

Assuming (*arguendo*) that the price of Nazareth "shares" had to be equal, *per share*, to all (whatever the ground): The *remedy* for under-payment of the aggregate price is *not* forfeiture of some of the aggregate shares. If the "shareholder" affirms his purchase, the remedy is *assessment* or call of the unpaid portion of the price for all shares he contracted to buy. This is the general law applied to *non*-corporate business associations, *e.g.*, partnerships, joint ventures, syndicates: and it approximates the Pennsylvania law—and remedy—applied to insufficiency of consideration for *corporate* stock subscribed for. The other members of the association might be entitled to rescind their own purchases of "shares," or to dissolve the venture or association; or they (or their creditors) might have a lien on the "shares" not fully paid for; and they might enforce that lien by foreclosure and sale. But forfeiture—disfavored in equity—is barred, absent explicit contract otherwise.[155] The Nazareth stock-claimants have no more *direct* right to redistribution of shares *inter se* in a non-corporate context, based on variation in purchase price of Nazareth "shares," than they have *derivatively* through Nazareth to reduce shares by forfeiture on the ground of non-payment of the subscription price owed to Nazareth for its corporate stock.

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[155] *Patterson* v. *Silliman*, 28 Pa. 304, *at* 313-5 (1857, *per* KNOX, *J.*); *Reiter* v. *Morton*, 96 Pa. 229 (1880, *per* GREEN, *J.*); *Akin* v. *Luce*, 63 Hun 632, 18 N. Y. S. 392 (Gen. T., 1st Dept., 1892, *p. c.*); *Westwood* v. *Grissey*, 139 A. D. 841, 124 N. Y. S. 97 (4th Dept., 1910, *per* SPRING, *J.*). *See Meinhard* v. *Salmon*, 249 N. Y. 458, *at* 469-462, 164 N. E. 545 (1928, *per* CARDOZO, *C. J.*). *See also Tompkins* v. *C. I. R.*, 97 F. 2d 396, *at* 399-400 (4th Cir., 1938, *per* WAY, *D. J.*); 2 *Rowley on Partnership* (2d ed., 1960) §§ 52.26-.28, 52.43.

(c) The "Greater equity * * * achieved by calculating the allowed claims in terms of dollars rather than in invalidly [*sic*] issued shares" (R. 593) is moot at best. Kanter's stock-claim provides dramatic illustration. No one is more aggrieved by the money index than Kanter (or Wolf, his assignee).

The District Court credited Kanter for $8,800 in "capital" invested in Nazareth, comprising $4,000 contemporaneously advanced to Malakoff in April of 1951, plus $4,800 credited in September of 1951 against "antecedent debts" or "investment exchanges." From November 1951 through April 1953, Kanter received $200 per month from Malakoff, aggregating $3,800, and representing a return of 20% per annum on $12,000—not $8,800 (reflecting Malakoff's promise of "shares" in April 1951) (R. 57-63). The District Court deducted that $3,800 in "dividends" from Kanter's "capital" of $8,800, and allowed Kanter $5,000 as the "net fair value of his investment" and his "interest" in Nazareth—*i.e.*, in Nazareth assets, income, and control (R. 232, 241, 262-3).

The Court of Appeals, partly rectifying the disparities in the District Court's index, allowed "interests" in Nazareth according to the entire "capital" initially "invested," without deducting "dividends" as "return of capital." However, the Court of Appeals raised an *in rem* liability on the new Nazareth shares, to secure repayment of those "dividends" out of future "distributions" by Nazareth on those shares (R. 593, 598-9). Thereby, Malakoff's past "dividends" would reduce Kanter's share of future Nazareth income, and perhaps assets on liquidation, but would not reduce shares of control (*i.e.*, votes). The Court of Appeals disallowed Kanter's stock-claim to eight shares, because the $4,800 paid therefor in September 1951 was "antecedent indebtedness to [Malakoff] and other transactions with him unrelated to the Nazareth venture as consideration" (R. 594-5). Kanter's entire $3,800 in "dividends" on the $8,800 would be charged against his new shares. Thus, Kanter would receive an "interest" of $4,000

for his April 1951 "investment" alone, encumbered by a $3,800 "dividend" charge—a net allowance of $200!

By contrast, others who came in at the end (*e.g.*, Tess J. Schwartz, who advanced $3,000 to Malakoff late in March of 1953, through her brother, an early "investor," and who received no "dividends" [R. 130-2, 238, 262-3]) were allowed their full advances as "interests" in Nazareth (R. 262-3, 594-5)—a solvent corporation—in a rising stock-market for Nazareth shares.

(i) As a matter of *fact*, the definitions of "investment" and the treatments of "dividends" by both Courts below, though differing, necessarily depend in common on *tracing those* "dividends" and other payments *by* Malakoff *to* the stock-claimants, as well as tracing payments *to* Malakoff *by* the stock-claimants. But there is no "tracing" of "dividends" in fact. (*See* pp. 25-27, *supra.*) Absent tracing, both definitions of "investment" and both treatments of "dividends" below are erroneous.

(ii) As a matter of *law*, the definitions of "investment" and the treatments of "dividends" by both Courts below, though differing, depend in common on *Malakoff's contracts* with the stock-claimants. If the Courts below are to equate payments *to* Malakoff as payments to Nazareth (or for Nazareth stock) only because of Malakoff's agreement to that effect, and if the Courts below are to equate payments *by* Malakoff as payments by Nazareth only because of Malakoff's earmarking, then the true accounts between *Malakoff* and the stock-claimants (*e.g.*, Kanter) should determine what was "capital" and what was "return of capital" under the reasoning of both Courts below. *A fortiori*, if Malakoff's conduct and contracts are to determine the participation of the stock-claimants in Nazareth stock under the reasoning of both Courts below, the explicit stock-purchase contracts between Malakoff and the stock-claimants—which stated precisely what "shares" the stock-claimants were to receive—should be definitive. There is no "equity" in the Courts below re-writ-

ing those stock-purchase contracts, yet implying different contracts from *Malakoff's* conduct and promises in order to give certain stock-claimants (*e.g.*, Weinstein, a lawyer) a bargain they never made or paid for.

2. *Under applicable state rules of decision, Malakoff's sales of 262 Nazareth shares were legally "present sales" of "when-issued" stock or "future goods." All 36 stock-claimants should share ratably in the limited fungible mass of 200 authorized Nazareth shares eventually issued.*

(a) The law of sales of goods applies to Malakoff's sales of "shares" of Nazareth stock, and determines distribution among the stock-claimants here. The *tripartite* relationship among Malakoff, Nazareth, and the 36 stock-claimants is fundamental, and fact. Irrespective of Malakoff's fiduciary relationship to Nazareth and/or the stock-claimants, he acted as an independent third-party seller in the critical transactions—the sale of Nazareth stock. He purported to sell specific numbers of "shares" which he purported then to own; yet, those "shares" were not then legally owned by Malakoff (except the first 20 during part of the period in issue). He misrepresented, of course, warranting suit against him for damages or the price—an option unexercised by the stock-claimants, and worthless. To the extent that the stock-claimants affirmed their stock-purchase contracts and looked to the "shares," not to Malakoff, they became tenants in common of a mass of stock which Malakoff eventually acquired and was entitled—and required—to appropriate to fulfill his contracts with the stock-claimants. He did "appropriate" the after-acquired property, by the issuance of shares of Nazareth stock to the stock-claimants; and they accepted. To the extent that the recipients of the oversales were not—and could not be—identified, all 36 stock-claimants are similarly situated *inter se* as to their respective rights against the authorized and issued shares, whether 200 or 20 or any other number within the authorized limit. It is as if all 36 stock-claimants had bought their "shares" on the same

day, with identical equities in the fungible mass of Nazareth stock. The corporate overissue (by contrast to Malakoff's oversale) is no more significant than if Malakoff had purported to sell 262 shares of AT&T while he bought only 200.

Shares of corporate stock purchased from a dealer or trader for his own account, are legally fungible goods, like grain, until delivered.[156]

> "* * * under that contract, no title to the stock passed at that time to the plaintiff. The seller did not, at that time, have title to the stock which it agreed to sell, and did not make any contract whereby it undertook to make a present transfer of the property in specific goods. The defendant's contract was a 'contract whereby the seller agrees to transfer the property in goods to the buyer.' [P. P. L.] § 82. The goods were then unascertained. The defendant might thereafter acquire goods of the stipulated description for the purpose of complying with its contract to transfer property in goods of that description to the buyer, but the property in the goods acquired would pass to the buyer only when such goods 'in a deliverable state are unconditionally appropriated to the contract * * * with the assent of the buyer.' P. P. L. § 100, rule 4; [case cited]." [157]

Until the seller's acquisition of title to the goods he has sold, each buyer is an owner in common of a share in the unascertained mass. When the seller does take title,

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[156] *Wills* v. *Investors Bankstocks Corp.*, 257 N. Y. 451, 178 N. E. 755 (1931, *per* LEHMAN, *J.*); *Agar* v. *Orda*, 144 M. 149, 258 N. Y. S. 274 (Sup., N. Y., 1932, *per* SHIENTAG, *J.*), *aff'd* 239 A. D. 827, 264 N. Y. S. 939 (1st Dept., 1933, *p. c.*), *aff'd* 264 N. Y. 248, 190 N. E. 479 (1934, *memo*). In Pennsylvania, too, the sale of corporate stock was governed by the Uniform Sales Act during the years in question (1951-53); *Howell* v. *McCloskey*, 375 Pa. 100, 99 A. 2d 610 (1953, *per* ARNOLD, *J.*); *Cochran* v. *Posey*, 148 Pa. Super. 492 (1942, *per* KENWORTHY, *J.*).

[157] *Wills* v. *Investors Bankstocks Corp.*, *supra*, n. 156, 257 N. Y. *at* 456-7.

he is expected to perform his contracts of future sale, and to deliver in turn to his buyers what he has promised them. Failing the seller's appropriation of the goods to his contracts and delivery to his buyers, each buyer has the right to appropriate his ratable share of the mass, subject to the rights of other owners in common—but each buyer is accountable to the other owners in common for any excess he may appropriate or withdraw for himself. For any undelivered balance, the purchaser has an unsecured claim against the seller for the price or damages.[158]

> "[§ 86] 3. Where the parties purport to effect a *present sale of future goods*, the agreement operates as a contract to sell the goods."
>
> "[§ 87] 1. * * * If the parties intend to effect a present sale [of an undivided share of goods], the *buyer*, by force of the agreement, becomes an *owner in common* with the owner or owners of the remaining shares.
>
> "2. In the case of *fungible goods*, there may be a sale of an undivided share of a specific mass, *though the seller purports to sell and the buyer to buy a definite number*, * * * of the goods in the mass, * * *. By such a sale the buyer becomes owner in common of such a share of the mass as the number * * * bought bears to the number * * * of the mass. * * *"[159]

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[158] N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) §§ 86, 87, 98, 99, 100 (Rule 2), (Rule 4[1]); 69 Purdon's Pa. Stats. Ann. §§ 61, 62, 141, 142, 143 (Rule 2), (Rule 4[1]). P. L. 543 [Uniform Sales Act] §§ 5, 6, 17, 18, 19 (Rule 2), (Rule 4[1]) (1915) (*repealed* 1953). *See Kimberly* v. *Patchin*, 19 N. Y. 330 (1859, *per* COMSTOCK, *J.*); *Conard* v. *Penn R. Co.*, 214 Pa. 98, 63 A. 424 (1906, *per* MESTREZAT, *J.*); 1 *Williston on Sales*, §§ 146-159. *See also U. S.* v. *Raymond [Intermingled Cotton Cases]*, 92 U. S. 651 (1876, *per* WAITE, *C. J.*). *Accord*: 12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code), § 2-105(2), (3), (4); P. L. 3, § 2-105(2), (3), (4) (1953); *see* Pa. Bar Assn. Notes (1)(c), (2), (3); U. C. C. Comment 1 (last par.), 2.

[159] N. Y. P. P. L. §§ 86, 87, *supra*, n. 158 (*emphasis supplied*).

The buyers' rights *inter se* and to the mass, are determined by their respective contracts with the common seller. As with any other sale of goods, consideration for the contract between the dealer and the buyer, if proof is required at all,[160] may be antecedent or future as well as present.[161]

Like principles have been applied, and appropriate results reached, where corporate stock has been over-subscribed (though not actually overissued).[162]

(b) The Court of Appeals, in purporting to "do equity," has disregarded the body of equity jurisprudence evolved over centuries, and has substituted private notions of fairness. Equity displaces legal rights, and replaces legal remedies, only where the chancellor's conscience is shocked by the anticipated result at Law, and only where the petitioner for relief in Equity can prove superior "equities" in the contested title. The federal chancellor is bound both by the judge-made body of Equity he invokes, and by the precedence of apposite—and applicable—Equity under the state law which defines the property rights in issue.

Applicable state rules of decision have erected elaborate safeguards for stockholders, and have provided for the sharing of a fund of after-acquired property, irrespective of misrepresentations by the seller of shares. In those rules of decision is embodied a policy—an Equity—which abhors,

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[160] N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) § 150(1); 69 Purdon's Pa. Stats. Ann. § 337(1), P. L. 543 [Uniform Sales Act] § 76(1) (1915) (*repealed* 1953). *See also* N. Y. P. P. L. (40 McKinney's N. Y. Consol. L.) § 33(3); L. 1941, c. 331, § 3, *amended* L. 1943, c. 5; L. 1944, c. 588, § 5.

[161] N. Y. Pers. Prop. L. (40 McKinney's N. Y. Consol. L.) §§ 33(1), 33(4); L. 1934, c. 142; *subd. 3 added by* L. 1941, c. 331, § 3; *amended by* L. 1943, c. 5; L. 1944, c. 588, § 5. *See also Sea Modes, Inc.* v. *Cohen*, 309 N. Y. 1, 127 N. E. 2d 723 (1955, *per* DESMOND, *J.*) (*account stated*).

[162] *Lathrop* v. *Knceland*, 46 Barb. [N. Y.] 432 (Gen. Term, 1866, *per* WELLES, *P. J.*, JOHNSON, SMITH, *JJ.*) [*Pa. corp.*]; *Buffalo & N. Y. C. R. R. Co.* v. *Dudley*, 14 N. Y. 336 (1856, *per* JOHNSON, SELDES, *JJ.*).

and avoids, secret liens and forfeitures. The "legal" remedies permit participation in Nazareth stock by all stock-claimants—all equally innocent of wrongdoing—rather than exclusion of a few. If those rules and remedies lack the greater appeal to conscience, if they fail to please, they scarcely shock or appall.

If, nevertheless, Law must yield to Equity here, then that Equity embraces its own rules to ascertain "reliance" and to impute "notice," in order to determine equities and priorities of ownership. By the Court of Appeals' own construct of the resulting trust, Equity conclusively imputes such "notice"—Malakoff's knowledge of other transfers—to his principals or *cestuis*, who can cut off no earlier equities, however deficient as against third parties. The *bona fide* purchaser in equity has, for centuries, been the buyer "for value" *and* "without notice." If these hoary principles apply, they should apply whole. Equity is equal treatment to litigants equally situated.

It is not mere inconsistency below in the invocation and application of Equity, that occasions review here. The Court of Appeals labored to apply medieval principles that still operate ideally *vis-à-vis* the wrongdoer, and among persons some or all of whom enjoyed confidential relations with the wrongdoer. Too often, Equity operates by a chronological mechanics and with an all-or-nothing result, notwithstanding provision for contribution and marshalling. Much of Equity, judge-made, clings to the protection of the principal against the agent's fraud, and the protection of the title vested earliest; a heavy burden falls on the would-be good-faith purchaser. Meanwhile, the Law has marched into the 20th Century with codifications—not only the procedural mergers of Law and Equity, but the uniform acts, and now the Code. The Law begins, slowly and fitfully, to favor the good-faith purchaser over the owner whose absconded agent had usurped authority or title. "Notice" is less technically imputed; "antecedent indebtedness" is good consideration.

The *forms* of *paper* exchanged become less decisive. Exacting scrutiny is not "commercially reasonable" in the market; a creditor's acceptance of payment in kind, and his forbearance from pursuit of his debtor while his debtor slides into insolvency, cast doubt on the wisdom of requiring contemporaneous consideration to support a good-faith purchase.[163]

Decision in No. 27000 should be corollary to *Erie*: federal forum-shopping is irrelevant to substantive adjudication. Decision should further recognize that Law and Equity grow outside the courts, too: Equity abroad, judge-made or statutory, may be as sound and "equitable" as the Equity invoked in the home forum—or more so. That, too, is *Erie*—and appropriate to *Nazareth*.

No. 26362

Denial of all compensation, future and past, to Weinstein and Fried, and their removal from office as president and director and as general manager (respectively) of the Debtor in possession, are mandatory under Chapter X, in consequence of their trading in the Debtor's stock and their self-dealing in the Debtor's rents during the Chapter X proceedings.

The principal questions before the Court in No. 26362 are the proper choice of law as to Chapter X fiduciary compensation, and the interpretation of § 249[166] and § 221(4).[167]

> "§ 249. * * * No compensation * * * shall be allowed to any * * * person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, * * *."

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[163] *See* Gilmore, Commercial Doctrine of Good Faith Purchase, 63 Yale L. J. 1057 (1954).

[166] Bankruptcy Act, § 249; 11 U. S. C. § 649; 52 Stat. 901 (1938).

[167] Bankruptcy Act, § 221(4); 11 U. S. C. § 621(4); 52 Stat. 897 (1938).

"§ 221. The judge shall confirm a plan if satisfied that— * * *

"(4) all payments made or promised by the debtor * * *, for service * * * in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable * * *; * * *."

The relief sought here by Wolf against Weinstein and Fried, is (1) denial of *compensation* to them out of the estate, and (2) their *removal* from office as the Debtor's president and director and as the Debtor's general manager (respectively). The misconduct constituting the grounds for that relief, is (1) their trading in the Debtor's stock, and (2) their self-dealing in the Debtor's rents, *during* the proceedings.

The law relating to fiduciary diversion and *restitution* of estate property (or indemnity for loss) is *not* necessarily the same as the law relating to compensation and removal from office; the differences in principles and results may appear in the same case.[168] Wolf's petition addressed to restitution of the rents diverted from the Debtor to Fried, was severed from the petitions at bar, and remains pending below. (*See* No. 27284, 303 F. 2d 152.) No petition is pending in any court addressed to restitution of Weinstein's and Fried's profits on their trading in the Debtor's stock. Both the Court of Appeals and the District Court confined their respective rulings to the stock trading, without ruling on the rent diversions.

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[168] *E.g., Crites, Inc.* v. *Prudential Ins. Co.*, 322 U. S. 408 (1944, *per* MURPHY, *J.*); *Beatty* v. *Guggenheim Exploration Co.*, 223 N. Y. 294, 119 N. E. 575 (1918, *per* CUDDEBACK, *J.*), *rearg.* 225 N. Y. 380, *at* 383, 122 N. E. 378 (1919, *per* CARDOZO, *J.*).

A. Both § 249 and § 221(4) mandate denial of all compensation out of the estate to Weinstein and Fried, as Chapter X fiduciaries, in consequence of their trading in the Debtor's stock during the proceedings.

In 1938, Congress enacted § 249 and § 221(4), the crucial statutes involved in No. 26362. Those provisions were part of the Chandler Act which created Chapter X and otherwise broadly amended the Bankruptcy Act.[169] The paramount aims and principles of § 249, and within the more comprehensive § 221(4), are twofold: (a) the prohibition of insider trading in the debtor's securities during the proceedings, as a Congressional and judicial *end* and policy, *per se*; and (b) the denial of compensation from the estate to insiders who trade despite the prohibition, as the *means* of effectuating that policy and attaining that end.

Before 1934, corporate reorganizations had generally been effected in federal equity receiverships. Unlike "straight" bankruptcies, where creditors and stockholders received cash liquidating dividends out of the proceeds of sale of the bankrupt's assets, reorganizations provided an *exchange* of new *securities* for old; the sale of assets to a new corporation was a fiction. By contract and under state and federal law, the rights and priorities of creditors and stockholders were defined in terms of liquidation. Absent liquidation, the priorities were theoretically respected; but, in practice, they depended upon a "plan of reorganization" which was formulated by a process of opinion evidence, argument, and bargaining as to the value of the estate as a going-concern and the participation of the different classes of securities. There was little judicial scrutiny or control. The different classes were "represented" by "protective committees"; the debtor's management, elected by the common stockholders, usually

[169] Chandler Act of June 22, 1938, ch. 575, §§ 1 *et seq.*; 52 Stat. 883 *et seq.*; 11 U. S. C. §§ 501 *et seq.*; *amending* Nelson Act of July 1, 1898, ch. 541, §§ 101 *et seq.*; 30 Stat. 544 *et seq.*

undertook to act for those stockholders, while often remaining in control of the business. By 1934, amid the great depression, equity receiverships had become infamous for insiders' abuse of the judicial process to reap windfalls for themselves by using their control and confidential information in buying and selling the debtor's securities for their own accounts during the proceedings. Moreover, virtually all control over compensation and expenses had been left by the courts in the hands of private parties, especially old management and the "protective committees", who thereby mulcted the estate directly.[170]

In 1934, exercising its powers under the Constitutional bankruptcy clause and judiciary article, Congress improved upon the equity receivership by adding § 77B to the Bankruptcy Act, so establishing a statutory form of corporate reorganization. Among the innovations were the debtor in possession ("a receivership without a receiver"), provision for recouping insider profits on purchases of the debtor's securities during the proceedings, and some degree of judicial control over compensation and expenses, provided for in § 77B(b),[171] § 77B(c),[172] and § 77B(f)(5):[173]

> "[§ 77B](b) A plan of reorganization within the meaning of this section * * *: *Provided*, That the judge shall scrutinize * * * and may limit any claims filed by such committee member or agent, to the actual consideration paid therefore. * * *"
>
> "[§ 77B](c) * * * the judge, * * * (9) may allow a *reasonable compensation* for the services rendered

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[170] *See Leiman* v. *Guttman*, 336 U. S. 1 (1949, *per* DOUGLAS, *J.*); *Northern Pac. Ry. Co.* v. *Boyd*, 228 U. S. 482 (1913, *per* LAMAR, *J.*); 6 *Collier on Bankruptcy* ¶¶ 0.04, 0.05, 7.05.

[171] Bankruptcy Act, § 77B(b) [*second proviso*]; 11 U. S. C. § 207(b); 48 Stat. 915 (1934) [*Repealed*].

[172] Bankruptcy Act, § 77B(c); 11 U. S. C. § 207(c); 48 Stat. 915 (1934) [*Repealed*].

[173] Bankruptcy Act, § 77B(f)(5); 11 U. S. C. § 207(f)(5); 48 Stat. 919 (1934) [*Repealed*].

* * * in connection with the proceeding and the plan by *officers*, * * * or other representatives of creditors or stockholders, and the attorneys and *agents* of any of the foregoing, and *of the debtor*, * * *. * * * *While the debtor is in possession* (a) its *officers* shall be entitled to receive only such *reasonable compensation* as the judge shall from time to time approve, and (b) no person shall be elected or appointed to any office, to fill a vacancy or otherwise, without the prior approval of the judge." (*Emphasis supplied.*)

"[§ 77B(f) * * * the judge shall confirm the plan if satisfied that * * * (5) all amounts *to be paid* by the debtor * * * for services or expenses incident to the reorganization have been fully disclosed and are *reasonable*, * * *." (*Emphasis supplied.*)

Under § 77B, two reorganizations in the Southern District of New York presented situations where committee members, applying to the reorganization courts for allowances of compensation, were found to have traded in securities of the debtor during the proceedings—and therefore were denied all compensation: *Paramount-Publix*[174] and *Republic Gas*.[175] In *Paramount-Publix*, in 1935, Judge Coxe invoked the phrase "reasonable compensation" in § 77B(c) and § 77B(f)(5) as statutory authority for applying principles of equity:

"All reorganization expenses are now expressly declared to be proper subjects of judicial scrutiny and determination. Indeed, there can now be no judicial confirmation of a corporate reorganization plan unless the reorganization expenses have been fully disclosed

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[174] *In re Paramount-Publix Corp.*, 12 F. S. 823 (S. D. N. Y., 1935, *per* COXE, J.).

[175] *In re Republic Gas Corp.*, 35 F. S. 300 (S. D. N. Y., 1936, *per* CAFFEY, J.).

and are reasonable, or are to be subject to the approval of the judge.' Section 77B(f)(5), * * *." [176]

> "The statute [§ 77B(c)(9)] permits the payment of *reasonable compensation* to committee members 'for services rendered.' *This necessarily implies loyal and disinterested service* in the interest of the persons for whom the committee assumes to act, and a committee member who, during his period of services, purchases and sells, or purchases, for personal gain, securities of the company which he is engaged in trying to reorganize, is not entitled to an allowance for his services as a committee member." [177]

A year later, in *Republic Gas*, Judge Caffey quoted Judge Coxe's opinion in *Paramount-Publix*, and followed Judge Coxe's reasoning and decision.

Section 77B was an emergency stop-gap measure.[178] In 1938, after much study, Congress replaced § 77B with Chapter X. Many provisions of § 77B were carried over, in modified form, into Chapter X. *E.g.:* § 77B(c)(9) [179] became § 241 [180] (*inter alia*):

> "§ 241. The judge may allow * * * reasonable compensation for services rendered * * * in a proceeding under this chapter [X]—* * * (3) by the trustee and other officers, * * *."

The last unnumbered sentence of § 77B(c) [181] became § 191: [182]

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[176] *In re Paramount-Publix Corp.*, *supra*, n. 174, 12 F. S. *at* 827.
[177] *Id.*, 12 F. S. *at* 828 (*emphasis supplied*).
[178] *See* 6 *Collier on Bankruptcy* (14th ed.) ¶ 0.05; *Report* No. 1409 *of* House Judiciary Committee *on* H. R. 8046, 75th Cong., 1st Sess. (1937), *at* 38-40.
[179] Bankruptcy Act, § 77B(c)(9), *supra*, n. 172 (*quoted in text*).
[180] Bankruptcy Act, § 241; 11 U. S. C. § 641; 52 Stat. 900 (1938).
[181] Bankruptcy Act, § 77B(c), *supra*, n. 172 (*quoted in text*).
[182] Bankruptcy Act, § 191; 11 U. S. C. § 591; 52 Stat. 893 (1938).

"§ 191. A trustee or debtor in possession may employ officers of the debtor at rates of compensation to be approved by the court. No person shall become an officer or director of the debtor, to fill a vacancy or otherwise, without the prior approval of the court."

The second proviso of § 77B(b) [183] became § 212:[184]

"§ 212. The judge * * * may limit any claim or stock acquired by such person or committee * * * in the course of the proceeding under this chapter [X] to the actual consideration paid therefor."

Section 77B(f)(5) [185] became § 221(4):[186]

"§ 221. The judge shall confirm a plan if satisfied that— * * *

"(4) all payments made or promised by the debtor * * *, for services * * *-in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable * * *; * * *."

Section 249 [187] was new; it had no explicit predecessor in § 77B.

"§ 249. * * * No compensation * * * shall be allowed to any * * * person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, * * *."

Through a late legislative compromise, the "debtor in possession" was retained, but only in marginal cases, *i.e.*, where

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[183] Bankruptcy Act, § 77B(b) *supra*, n. 171 (*quoted in text*).
[184] Bankruptcy Act, § 212; 11 U. S. C. § 612; 52 Stat. 895 (1938).
[185] Bankruptcy Act, § 77B(f)(5), *supra*, n. 173 (*quoted in text*).
[186] Bankruptcy Act, § 221(4); 11 U. S. C. § 621(4); 52 Stat. 897 (1938).
[187] Bankruptcy Act, § 249; 11 U. S. C. § 649; 52 Stat. 901 (1938).

indebtedness did not exceed $250,000, and where the judge so elected.[188]

Thus, much of the sweeping reform in 1938 of the 1898 Bankruptcy Act was addressed to "fiduciaries" acting in the proceedings, to assure salvage of investment, and to prevent insider plunder. "The statute [Chapter X] was designed to police the return which all security holders obtain from reorganization plans." [189] "The indicated purpose [of Chapter X] was to strengthen not to impair the existing controls which § 77B established in regard to allowances." [190] "'Reasonable compensation for services rendered' necessarily implies loyal and disinterested service in the interest of those for whom the claimant purported to act." [191]

Trustees and "other officers" of any estate being administered under the Bankruptcy Act, were absolutely forbidden to purchase any *assets* of the debtor during the proceedings, irrespective of the fairness of the transaction: [192]

> "§ 154. * * * Whoever, being a * * * trustee, * * *, or other officer of the court, knowingly purchases, directly or indirectly, any property of the estate of which he is such officer in a bankruptcy proceeding: * * *

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[188] Bankruptcy Act, § 156, 11 U. S. C. § 556, 52 Stat. 888 (1938); *see* 6 *Collier on Bankruptcy* ¶ 7.01[2], 7.05; *Hearings before* Senate Judiciary Committee *on* H. R. 8046, 75th Cong., 2d Sess. (1937-38) *at* 50.

[189] *Leiman* v. *Guttman*, 336 U. S. 1, *at* 8 (1949, *per* DOUGLAS, *J.*).

[190] *Leiman* v. *Guttman*, *supra*, n. 189, 336 U. S. at 5, n. 2. *See* 6 *Collier on Bankruptcy* ¶ 13.01, 1318.

[191] *Woods* v. *City National Bank & Trust Co.*, 312 U. S. 262, *at* 268 (1941, *per* DOUGLAS, *J.*); *American Mut. L. Ins. Co.* v. *City of Avon Park*, 311 U. S. 138 (1940, *per* DOUGLAS, *J.*). *See* Statement *by* William O. Douglas (then S. E. C. Commissioner) *at Hearings before* House Judiciary Committee *on* H. R. 6439, 75th Cong., 1st Sess. (1937), *at* 126.

[192] 18 U. S. C. (Criminal Code) § 154; 62 Stat. 690 (1948), *based on* Bankruptcy Act, § 29c, 11 U. S. C. § 52(c), 30 Stat. 554 (1898), 52 Stat. 856 (1938) [§ 29c *repealed*]. *See* 2 *Collier on Bankruptcy* ¶ 29.13.

"Shall be fined not more than $500, and shall forfeit his office, * * *."

In view of the nature of corporate reorganizations, the Chandler Act also undertook to prevent *all* fiduciaries from *any* purchase *or* sale of the debtor's *securities* during the proceedings. Both the reorganization legislation and the securities regulation enacted by Congress in the 1930s were in the same context, subject to the same influences, and largely directed to the same objectives.[193] However, the legal methods differed. The Securities Exchange Act of 1934, in § 16(b), provided for an absolute "constructive trust" of all insider "short-swing" profits on listed stocks "traded" (*i.e.*, bought *and* sold) within a six-month period, "For the purpose of preventing the unfair use of information which *may* have been obtained by such beneficial owner [in "control"], director, or officer by reason of his *relationship to the issuer*, * * *." [194] Congress—with much the same purpose—directed the cognate regulation of insider trading in Chapter X proceedings to compensation as well as profits. Provision for recouping insider profits on purchases of the debtor's securities, was carried over from § 77B(b) to § 212; but, unlike the § 16(b) mandate, § 212 left the Chapter X judge with discretion as to relief. *In addition* to *restitution* of insider profits, Congress prohibited *compensation* to insiders who bought *or* sold *at any time* during the proceedings—irrespective of profits; and, like § 16(b), the § 249 relief is manda-

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[193] *See, e.g., Report of* Percival E. Jackson, Counsel to Special Committee of U. S. Senate to Investigate Bankruptcy and Receivership Proceedings *etc.*, Sen. Doc. No. 268, 74th Cong., 2d Sess. (1936), *at* 51-3, 87; 2 Loss, *Securities Regulation* (2d ed., 1961), *at* 719-720, 1124-6.

[194] Securities Exchange Act of 1934, § 16(b); 15 U. S. C. § 78p (b); 48 Stat. 896 (1934) (emphasis supplied). *See Adler v. Klawans*, 267 F. 2d 840 (2d Cir., 1959), *per* BUSSEY, J.

tory. Those two sections of Chapter X—§ 212 and § 249—are cumulative, not exclusive.[195]

§ 249

The legislative history and purpose of § 249 may be seen, for example, in a statement to the House Judiciary Committee in 1937, made by William O. Douglas, a principal draftsman of Chapter X, and then a commissioner of the S. E. C., in explanation and support of § 249:

> "The Chandler bill makes further significant changes in that respect. On page 65 there is a very important provision, that those who have purchased or sold securities in contemplation of or after commencement of the proceedings should not be allowed compensation or reimbursement from the estate. Now, this is a development of the idea that fiduciaries who trade in the securities should be penalized; that is, where they act contrary to the spirit, at least, of the common law and, in certain types of transactions, contrary to the letter of the common law. * * *
>
> "Now, Judge Coxe up in New York in the *Paramount* case, and Judge Caffey in the *Republic Gas* case, the opinions which were handed down in 1935 and 1936, respectively, disallowed compensation to committee members who purchased or sold securities. Now, this provision on page 65, is a step toward the codification of that rule, an attempt to make it more uniform.

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[195] *See* 6 *Collier on Bankruptcy* (14th ed.) ¶ 9.31. In the following Chapter X cases, *both* § 212 and § 249 were applied as remedies for insider trading: *Young* v. *Potts*, 161 F. 2d 597 (6th Cir., 1947, *per* SIMONS, *J.*), *on remand from Young* v. *Higbee Co.*, 324 U. S. 204 (1945, *per* BLACK, *J.*); *In re Philadelphia & Western Ry. Co.*, 64 F. S. 738 (E. D. Pa., 1946, *per* KIRKPATRICK, *J.*); *In re Los Angeles Lumber Products Co., Ltd.*, 37 F. S. 708, 46 F. S. 77 (S. D. Cal., 1941, *per* JENNEY, *J.*).

"Mr. Celler: Due to their position they trade in the securities and gain a tremendous advantage?

"Mr. Douglas: Yes; by using inside information. We started to set this up another way, to say that if a person in a fiduciary capacity uses inside information to purchase or sell securities, then he shall be penalized, but we got into a lot of difficulties. We visualized a lot of administrative difficulties in determining in a particular case whether or not actual inside information was used, and so we decided that the best practical way of doing it was to broaden the base a little bit and establish a rule of thumb and follow the pattern of the *Paramount* case and the *Republic Gas* case." [196]

Since § 249 became law in 1938, this Court has never reviewed a § 249 case. However, this Court has stated:

"* * * In all cases persons who seek compensation for services or reimbursement for expenses are held to fiduciary standards. § 249, * * *; Woods v. City Nat. Bank & T. Co. [citation].* * * *" [197]

In any event, no need for this Court to review a § 249 case had arisen—until now. For invariably, *all* fiduciaries who traded for their own accounts during Chapter X proceedings, were held subject to § 249. Motivation, ignorance, inadvertence, gain or loss: invariably, all were held irrelevant. The Courts of Appeals rigorously applied § 249 in accordance with its legislative history and purpose, from the first appellate decision in 1940—

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[196] *Hearings before* House Judiciary Committee *on* H. R. 6439, 75th Cong., 1st Sess. (1937), *at* 183-4. *See ibid.*, *at* 312-3; *Hearings before* Senate Judiciary Committee *on* H. R. 8046, 75th Cong., 2d Sess. (1937-38), *at* 127-8; *Report* No. 1916 of Senate Judiciary Committee *on* H. R. 8046 (1938), *at* 7, 38.

[197] *Brozen* v. *Gerdes*, 321 U. S. 178, *at* 182 (1944, *per* DOUGLAS, J.).

"* * * It is doubtless true that the statute, thus construed, may work a hardship in some cases—as in this; but such sporadic cases are inconsiderable compared to the large object sought to be achieved by the law, which is to fix a standard of conduct by persons acting in fiduciary capacities, in these cases, so high as to prevent any possible clash between selfish interest and faithful performance of duty." [198]

—to the last, in 1959—

"* * * But in § 249 of the Bankruptcy Act Congress clearly intended drastic results and thought them necessary to eliminate the serious abuses of insider information which had long been existent in equity reorganizations. [Citation.] In the past excuses of inadvertence or *de minimis* have not been permitted to undermine the section, and we do not feel we can narrowly constrict it here. [Cases cited.]" [199, 200]

§ 221(4)

While this Court has not ruled on § 249, this Court has, since 1938, ruled on numerous reorganization cases involving compensation to fiduciaries. Repeatedly, this Court has held that the Chapter X courts must control the acquisition and distribution of *all* assets of the estate,[201] and that the Chapter X courts have and must exercise *exclusive* jurisdiction and

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[198] *Otis & Co.* v. *Insurance Bldg. Corp.*, 110 F. 2d 333, *at* 335 (1st Cir., 1940, *per* PETERS, *J.*).

[199] *Surface Transit, Inc.* v. *Saxe, Bacon & O'Shea*, 266 F. 2d 862, *at* 868 (2d Cir., 1959, *per* CLARK, *C. J.*), *cert. den.* 361 U. S. 862 (1959).

[200] *Accord: In re Midland United Co.*, 64 F. S. 399, *at* 412-8 (D. Del., 1946, *per* BIGGS, *Cir. J.*), *aff'd* 159 F. 2d 340 (3d Cir., 1947, *per* KALODNER, *J.*); *In re Central States Electric Corp.* [*Henis* v. *Egan*, 112 F. S. 281 (E. D. Va., 1953, *per* HUTCHESON, *C. J.*), *lv. to app. den.* 206 F. 2d 70 (4th Cir., 1953, *p.c.*), *cert. den.* 346 U. S. 899 (1953); *In re 188 Randolph Bldg. Corp.*, 151 F. 2d 357 (7th Cir., 1945, *per* SPARKS, *J.*).

[201] *U. S.* v. *Knight*, 336 U. S. 505 (1949, *per* DOUGLAS, *J.*).

control over *all* compensation which, directly or indirectly, is paid out of the estate and which thus affects the ultimate distribution of assets in judicial custody.[202]

> "Hence Congress instituted controls, controls which became more pervasive as § 77B was evolved into Chapter X. * * * And § 221(4) is written in pervasive terms—it applies to 'all payments' for services 'in connection with' the proceeding or 'in connection with' the plan and 'incident to' the reorganization, whoever pays them. * * * "[203]

> "These practical considerations support the literal reading of § 221(4) that it is the bankruptcy court that has jurisdiction to pass on these fees. Its jurisdiction is therefore exclusive. * * * "[204]

By statute, the Chapter X courts have retained all the powers of an equity receivership court.[205] Moreover, even where § 249 does not apply—that is, in Chapter X proceedings, where conflicts of interest exist other than trading in the debtor's securities—this Court has likewise denied compensation to the faithless fiduciaries. Statutory authority is given by § 221(4), a "scrutiny clause" which was carried over into Chapter X from § 77B(f)(5). The same statutory language—"reasonable compensation"—is used in § 221(4) as was used in § 77B(c) and § 77B(f)(5), the sections which were the statutory authority for *Paramount-Publix* and *Republic Gas*; and *Paramount-Publix* has been quoted and followed by this Court in applying the "scrutiny clause" of § 221(4) to deny compensation to Chapter X fidu-

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[202] *Brozen* v. *Gerdes*, *supra*, n. 197; *Leiman* v. *Guttman*, 336 U. S. 1 (1949, *per* DOUGLAS, *J.*); *See Austrian* v. *Williams*, 216 F. 2d 278 (2d Cir., 1954, *per* HARLAN, *J.*), *cert. den.* [*sub nom. Fogarty* v. *Austrian*] 348 U. S. 953 (1955).

[203] *Leiman* v. *Guttman*, *supra*, n. 202, 336 U. S. *at* 7-8.

[204] *Id.*, 336 U. S. *at* 9.

[205] Bankruptcy Act, § 115; 11 U. S. C. § 515; 52 Stat. 884 (1938).

ciaries who had conflicts of interest during the proceedings. The landmark is the *Woods* case:

> "Under chap. X of the Chandler Act the bankruptcy court has plenary power to review all fees and expenses in connection with the reorganization from whatever source they may be payable. [Footnote, quoting § 221(4).] Reasonable compensation may be allowed. * * * Furthermore, 'reasonable compensation for services rendered' necessarily implies loyal and disinterested service in the interest of those for whom the claimant purported to act. * * * It is no answer to say that fraud or unfairness were not shown to have resulted. * * * Where an actual conflict of interest exists, no more need be shown in this type of case to support a denial of compensation." [206]

The same strict rule stated in *Woods*—actual conflict of interest, without more, forfeits all compensation—has been applied by this Court in non-Chapter X bankruptcy reorganizations (*e.g.*, *Avon Park* [207]) and in federal receiverships outside bankruptcy (*e.g.*, *Crites* [208]). In *Avon Park*, the disqualifying conduct was insider trading in a proceeding under Chapter IX, which contains no such explicit provision as § 249, but which does contain a "scrutiny clause" similar to § 221(4). Enough that the trustee has concealed or diverted from his *cestuis* an *opportunity* for profit: the value of the opportunity, and the likelihood of its realization in quick assets, are irrelevant. Indeed, in *Crites*, this Court refused to surcharge the faithless trustee for the diverted profits—but this Court did deny him *all* compensation. "Normally" fee allowances are within the District Court's discretion, and

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[206] *Woods* v. *City National Bank & Trust Co.*, 312 U. S. 262, *at* 267-8 (1941, *per* DOUGLAS, *J.*).

[207] *American Mut. L. Ins. Co.* v. *City of Avon Park*, 311 U. S. 138 *at* 147 (1940, *per* DOUGLAS, *J.*).

[208] *Crites, Inc.* v. *Prudential Ins. Co.*, 322 U. S. 408 (1944, *per* MURPHY, *J.*).

reviewable only for "clear abuse"; but fiduciary conflict of interest "compels" complete denial of compensation.[209] The standard for fiduciary *compensation* in all *federal* receiverships, and particularly in Chapter X reorganizations, is absolute, and is different even from the federal standard for surcharge for loss or diversion of assets.

The Second Circuit soon confronted the *Woods* doctrine in Chapter X proceedings. In 1949, in the *Berner* case,[210] the Court of Appeals recognized that a fiduciary with a duty to an entire class of stockholders had no right to favor part of that class with an "opportunity" at the expense of another part of the class.[211] The applicant for compensation was not affected by § 249 because he had traded for the accounts of others, not for himself; however, the Court did find an actual misuse of confidential information, which the Court ruled a breach of trust to the sellers (though not the buyers). That was the *Avon Park* situation, and worse. Similarly, in the *Silbiger* case[212] in 1950, the Court found a conflict of interest by an attorney who had undertaken to represent two opposing classes of bondholders in the Chapter X proceedings, which the Court ruled a breach of trust; § 249 was inapplicable, since no trading was involved. That was the *Woods* situation. But in both *Berner* and *Silbiger*, the Court of Appeals ordered reduction—not complete denial—of compensation. The determination of fees was left to the district court and the parties on remand, subject to appellate review only for abuse of discretion. The amount of the reduction was to be measured largely by the amount of the insider profits.

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[209] *Id.*, 322 U. S. *at* 418.

[210] *Berner* v. *Equitable Office Bldg. Corp.*, 175 F. 2d 218 (2d Cir., 1949, *per* L. HAND, *J.*).

[211] *Id.*, *citing* (175 F. 2d *at* 220, n. 1) *Young* v. *Higbee Co.*, 324 U. S. 204 (1945, *per* BLACK, *J.*).

[212] *Silbiger* v. *Prudence Bonds Corp.*, 180 F. 2d 917 (2d Cir., 1950, *per* L. HAND, *J.*), *cert. den.* 340 U. S. 813 (1950).

> "* * * Nevertheless, since Congress limited the penalty of entire forfeiture to purchases by a fiduciary [under § 249], we should not be warranted in extending that penalty to the situation at bar; and we think that *the consequences should be only those which attend any breach of trust in equity*; i.e., that in determining what the trustee's compensation shall be, the court will, as a matter of *discretion diminish* the allowance which it would otherwise make, *in proportion to the gravity of the breach.* * * *" [213]

Thus came the enfeebling of § 221(4), *Woods*, and *Aron Park* in the Second Circuit, and the blurring of the distinction between denial of fiduciary compensation and restitution of insider profits. Cited were *Woods* and *Crites*, but not § 221(4). Where § 249, narrowly construed, was inapplicable, the Court looked to *general* equitable standards in all jurisdictions, not specifically to federal standards. The remedy was not absolute forfeiture of compensation; rather, it was reduction of compensation, gauged by the amount of the diverted assets—an alternative (as it were) to surcharge, which required proof of actual loss to the *cestuis* and a finding of good faith or bad faith.[214]

The inevitable has come in this case. Section 249 is construed to near-death. Section 221(4) is not cited. Now the remedy for insider trading is completely "equitable" and discretionary. Neither the Court of Appeals nor the District Court (on remittitur) has opted to impose the remedy at all. The rationale is recourse to state law, and the utter exclusion of federal law. The finale is disclaimer of breach of trust by a Chapter X fiduciary who buys or sells the

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[213] *Berner* v. *Equitable Office Bldg. Corp.*, *supra*, n. 210, 175 F. 2d *at* 222 (*emphasis supplied*).

[214] *See also Nichols* v. *S. E. C.*, 211 F. 2d 412, *at* 416-8 (2d Cir., 1954, *per* L. HAND, *J.*), *cert. den.* 348 U. S. 828 (1954); *In re Chicago & West Towns Rys., Inc.*, 230 F. 2d 364 (7th Cir., 1956, *per* DUFFY, *C. J.*), *cert. den.* 351 U. S. 943 (1956).

debtor's securities for his own account during the proceedings. The decision below confounds the language and policy of both § 249 and § 221(4), and clouds a hitherto clear *caveat* to all Chapter X insiders.

The Court of Appeals rested its decision on a strict construction of § 249. Purely as statutory construction, it is erroneous. More important, however, was the judicial *election* to construe § 249 strictly, not liberally, and the judicial inference of legislative intent. Without question, Congress may regulate Chapter X compensation, and may disqualify an applicant if he trades in the debtor's stock during the proceedings. Administration of bankruptcy estates is peculiarly within federal jurisdiction. The Court of Appeals has viewed such disqualification as "penal" (R. 580), not as "remedial."[215] Hence, its strict construction: Unless Congress has spoken unequivocally, § 249 does not apply; absent applicability of § 249, state law or "general" equity applies instead—which does not disqualify corporate managers from compensation in consequence of insider trading *per se*. The following words are the crux of Judge Friendly's opinion:

> "* * * Not being required to seek compensation under § 247, they have not been subjected to § 249, and the order of removal cannot survive the fall of its underpinning. [Footnote 5]" (R. 579)
>
> "* * * For these strangers [judge's appointees] the only road to compensation from the debtor's assets is interposition by the court—in sharp contrast to officers and employees of the debtor whose claim to compensation derives from *consensual arrangements*, subject only, in the case of officers, to judicial approval under § 191. * * * At the very least, courts are justified in demanding a clear indication of Congressional purpose before inflicting what we have recognized as so harsh a forfeiture, [case cited], upon persons who,

[215] *Cf. Adler* v. *Klawans*, 267 F. 2d 840, *at* 844 (2d Cir., 1959, *per* BURGER, J.).

despite their fiduciary obligations, had been free to buy or sell stock of the corporation before the Chapter X proceeding was contemplated [cases cited]. * * *." (R. 580; *emphasis supplied.*)

"* * * Chapter X clearly distinguishes between *what is demanded* of a trustee and *what is expected* of officers of a debtor in possession. Section 156 requires that the trustee (other than the additional trustee * * *) must be 'disinterested.' * * *. No such requirement was or practically could be imposed on officers of the debtor; * * *." (R. 580-1; *emphasis supplied.*)

"* * * Nothing we have said is to be construed as concluding that Weinstein and Fried did breach fiduciary obligations in the transactions of which appellees [Wolf] complain; * * *." (R. 582)

1. At once, there is a new order when a Chapter X petition is filed: federal law supervenes; the federal judge, above the stockholders, above the state legislature, is master; the debtor's officers are his servants. Some officers the judge newly appoints; some continue in service at executive level with his approval. The latter are compensated by regular salaries, instead of in gross at the winding-up.[216] Now says the Court of Appeals, the correlate of that *privilege* of continued service and regular salary (without "disinterestedness") would be, not a responsibility, but a license to trade in the debtor's securities during the proceedings, as before. Their trading would still be no breach of trust, absent proof of actual over-reaching and actual profit; even then, the remedy would be limited to restitution of their profits. In short, fiduciaries not required to *be* "disinterested" at the *commencement* of the Chapter X proceedings, would *also not* be required to *act* in a disinterested manner *during* the Chapter X proceedings. For them, Chapter X would bring no

[216] Bankruptcy Act, § 191; 11 U. S. C. § 591; 52 Stat. 893 (1938).

change. The strict federal standard would apply only to the few "disinterested" at commencement, while the loose non-federal standard would apply to the many not "disinterested"—though *all* had "assumed to *act in the proceedings* in a fiduciary capacity" (§ 249).

2. The Court of Appeals would disregard the *functions* of key operating personnel, their access to confidential information, and their actual control of the debtor being reorganized. Not their powers and acts, but their titles, would define their responsibilities—despite the lucid functional definitions of the Bankruptcy Act and the equity courts. Form, not substance, would govern.[217]

3. The decision below does not merely chip at § 249. It cleaves the statute and emasculates judicial control of compensation in Chapter X proceedings, thereby thwarting the Congressional and judicial purpose of preventing and penalizing insider trading. For the license to trade given by that decision would extend, not only to officers of a debtor in possession in a small case, but to all key operating personnel employed by a trustee or a debtor, in any case, big or small.

Moreover, the refusal to apply § 249 or § 221(4) or non-statutory principles of equity in Chapter X proceedings, would be precedent for like refusal in railroad reorganizations under § 77,[218] in S.E.C. public utility reorganizations,[219] and in other reorganization proceedings under the

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[217] Bankruptcy Act, §§ 1(22), (23), 188; 11 U. S. C. §§ 1(22), 1(23), 588; 52 Stat. 840, 892 (1938); *see* Point C, *infra*

[218] *See R. F. C. v. Bankers Trust Co.*, 318 U. S. 163 (1943, *per* ROBERTS, J.); DOUGLAS, J., *concurring*); 5 *Collier on Bankruptcy* ¶ 77.28.

[219] *See S. E. C. v. Dumaine*, 218 F. 2d 308 (1st Cir., 1954, *per* WOODBURY, J.), *cert. den.* 349 U. S. 929 (1955); *cf. Nichols v. S. E. C.*, 211 F. 2d 412 (2d Cir., 1954, *per* L. HAND, J.); *see also* 2 Loss, *Securities Regulation* (2d ed., 1961), *at* 1127-9.

Bankruptcy Act,[220] where the applicable statutes all contain language similar to the language of § 249 or § 221 (4).

4. As to the format and definitions of Chapter X:

(a) Judge Friendly has written that the "context" of § 249 is confined to Article XIII (§§ 241-250); *therefore*, § 191, in Article VIII, is not governed by § 249 (R. 579). The reason stated is *ipse dixit:* "it becomes fairly plain" (*Id.*). Yet, the legislative history shows an intention that the format was *not* to restrict the substantive application of any sections of Chapter X; *e.g.:*

> "* * * Thus it is that the largest part of the changes in the language of section 77B to be found in chapter X of this bill, are solely in the interests of clarification. For the most part, also, the rearrangement in this chapter of the provisions of section 77B has as its purpose a more logical order and grouping of related provisions which are presently to be found scattered throughout section 77B in much confusion. * * *" [221]

The point was made not only at hearings and in committee reports, but explicitly by statute:

> "b. Sections and subdivision headings shall not be taken to govern or limit the scope of the sections or subdivisions to which they relate." [222]

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[220] *E.g.*, Ch. IX; *see American Mut. L. Ins. Co.* v. *City of Avon Park*, 311 U. S. 138 (1940, *per* DOUGLAS, J.); *see also* 5 *Collier on Bankruptcy* ¶ 81.23.

[221] *Report* No. 1916 *of* Senate Judiciary Committee *on* H. R. 8046 (1938), *at* 19. *See also Hearings before* House Judiciary Committee *on* H. R. 6439, 75th Cong., 1st Sess. (1937), *at* 313-8; *Hearings before* Senate Judiciary Committee *on* H. R. 8046, 75th Cong., 2d Sess. (1937-38), *at* 117-9; 6 *Collier on Bankruptcy* ¶¶ 13.02, 13.16.

[222] Amendatory Act, § 5b; Additional Provisions of Act of June 22, 1938 (The Chandler Act, ch. 575, 52 Stat. 840 *et seq.*), § 5b; 11 U. S. C. § 1, notes, § 5b.

(b) Article XIII on "Compensation and Allowances" (§§ 241-250) is *not* self-contained. Article XI, on "Confirmation and Consummation of Plan" (§§ 221-229) also governs compensation; indeed, it contains the "scrutiny clause," § 221(4), which this Court has said to be "pervasive" of Chapter X,[223] and to govern Article XIII applications for allowances.[224] No reason appears to make § 249 any less "pervasive."

(c) Both § 241 and § 191 were derived from § 77B(c). The requirement that compensation be "reasonable" had been repeated in § 77B(c)(9) and in the last unnumbered sentence of § 77B(c), and again in § 77B(f)(5). That critical word "reasonable" was carried from § 77B(f)(5) into § 221(4), and from § 77B(c)(9) into § 241; but the word was omitted when the last unnumbered sentence of § 77B(c) was carried into § 191. The judge must still "approve" all compensation under § 191, as under its § 77B(c) predecessor. Unless the judge is now free to approve "*un*reasonable" compensation to officers of a debtor in possession, the standards governing such compensation must be found *outside* § 191 (Article VIII). There is no less reason to import § 249 from Article XIII into § 191, than to import the "pervasive" § 221(4) from Article XI.

(d) Referee Joyce (R. 41-2) and the respondents contend, and Judge Friendly suggests (R. 579), that the second sentence of § 249 (the denial of compensation) cannot apply unless the first sentence (the requirement of disclosing trading transactions) applies. Neither reason nor authority is given. *Assuming* the two sentences of § 249 must both apply, then the substantive policy of the second sentence should determine the disclosure procedure, *et vice versa*. Nor would weekly statements be required for weekly paychecks.

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[223] *Leiman* v. *Guttman*, *supra*, nn. 202-4 (*quoted in text*).

[224] *Woods* v. *City National Bank & Trust Co.*, 312 U. S. 262 (1941, *per* DOUGLAS, *J.*).

any more than statements under (say) § 210[225] need be filed prerequisite to each separate appearance in court by an attorney. Statements filed pursuant to Chapter X requirements are continuing representations to the court; additional statements need be filed only when new circumstances require new disclosures.[226]

5. The Court of Appeals has premised two principal distinctions for its posited double standard, in order to square its statutory construction with Congressional intent:

(a) "*Disinterested*": Whether an applicant for compensation out of the estate is required to be "disinterested" under § 158,[227] is immaterial to the applicability of § 249 and § 221(4). Under Chapter X, *only* the trustee,[228] the trustee's attorney,[229] and the examiner[230] are required to be "disinterested." It is not alone the officers and employees of a debtor in possession who need not be "disinterested." Likewise, virtually every other person serving in the proceedings, and looking to the estate for compensation, need *not* be "disinterested"; *e.g.*, the "additional trustee,"[231] attorneys on special retainers[232] and others employed by the trustee,[233] indenture trustees, committee members. *All* those persons, "disinterested" or not, will either apply for allowances under Article XIII, or their out-of-court compensation agreements with their clients will *necessarily* be subject to review of "reasonableness" by the Chapter X court under § 221(4). If those persons alone were subject to § 249 who were required to be "disinterested" under § 158, then § 249 would not govern most applicants for compensation under Article XIII.

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[225] Bankruptcy Act, § 210; 11 U. S. C. § 610; 52 Stat. 895 (1938).
[226] *See* 6 *Collier on Bankruptcy* ¶¶ 9.28-9.30.
[227] Bankruptcy Act, § 158; 11 U. S. C. § 558; 52 Stat. 888 (1938).
[228] Bankruptcy Act, § 156; 11 U. S. C. § 556; 52 Stat. 888 (1938).
[229] Bankruptcy Act, § 157; 11 U. S. C. § 557; 52 Stat. 888 (1938).
[230] Bankruptcy Act, § 168; 11 U. S. C. § 568; 52 Stat. 890 (1938).
[231] Bankruptcy Act, § 156, *supra*, n. 228.
[232] Bankruptcy Act, § 157, *supra*; n. 229.
[233] Bankruptcy Act, §§ 167(4), 191; 11 U. S. C. §§ 567(4), 591; 52 Stat. 890, 893 (1938). *See* 6 *Collier on Bankruptcy* ¶¶ 7.21, 8.14.

where § 249 is situated. And if those persons alone were subject to § 221 (4) and *Woods* who were required to be "disinterested" under § 158, then, in reviewing out-of-court compensation agreements, "reasonableness" would no longer "necessarily imply loyal and disinterested service."

The error below is the misconstruction of "disinterested." The word has two meanings. As used in § 158, "disinterested" is a term of art derived from *statute* and descriptive of a person's *status* at or *prior* to his appointment and the filing of the Chapter X petition. As used in *Woods* ("loyal and disinterested service"), the word is a term of art derived from *equity* and descriptive of a person's *conduct subsequent* to his appointment and throughout the proceedings.

The persons required to *be* "disinterested" under § 158 (trustee, trustee's attorney, examiner) are obliged to investigate the debtor's pre-Chapter-X operations, to advise on action against insiders and preferred creditors, and to formulate a plan of reorganization presumptively "fair and equitable" to all classes and presumptively "feasible" in avoiding the incompetent and/or fraudulent mismanagement that may have precipitated reorganization.[234] The man who was part of pre-Chapter-X management yesterday will not investigate himself today; the man who is a creditor or stockholder will favor the class of which he himself is a member; so Congress presumed—conclusively. The obligatory *functions* of the § 158 "disinterested" affect all classes interested in the estate; the *duty* to *all* bars identification with any.

By contrast, the obligatory functions of other Chapter X "fiduciaries" do not conflict with personal identification with a class; *e.g.*, representation of a particular class by a com-

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[234] *See* Bankruptcy Act, §§ 167, 168; 11 U. S. C. §§ 567, 568; 52 Stat. 890 (1938); *see also* 6 *Collier on Bankruptcy* ¶¶ 7.17-7.24; *Hearings before* House Judiciary Committee *on* H. R. 6439, 75th Cong., 1st Sess. (1937), *at* 174-7; *Hearings before* Senate Judiciary Committee *on* H. R. 8046, 75th Cong., 2d Sess. (1937-38), *at* 125-6.

mittee member or attorney, or operation of the debtor's business by its officers to preserve and enhance the estate for all classes. The duties imposed on a debtor in possession do not include those duties imposed on a trustee which require "disinterested" status; hence, provision for an examiner. Nevertheless, undertaking any duty to one class or more, the Chapter X "fiduciary" owes "disinterested" *conduct* in performance of that duty, under *Woods*. Once "disinterested" conduct is owed, the specific bar and mandate of both § 249 and § 221(4) apply. Thereupon, the courts will not inquire into particular effects upon particular classes, *for compensation purposes*. If this is true of committee members and attorneys who owe a duty to particular classes only, it is true, *a fortiori*, of the officers of a debtor in possession who have undertaken a duty to all classes in the operation of the business.

(b) *"Consensual arrangement":* The distinction between "interposition by the court" and "consensual arrangement" as the mode of appointment and/or compensation, is immaterial to the applicability of § 249 and § 221(4). Except the trustee, the additional trustee, the trustee's attorney, and the examiner, virtually every other person serving in the proceedings, and looking to the estate for compensation, is appointed and compensated by "consensual arrangements" with his respective clients. Nevertheless, *all* appointments are subject to judicial approval.[235] Even prospective management after the winding-up, are subject to judicial approval.[236] Likewise, *all* compensation is subject to judicial approval.[237] As likely as not, the prospective recipient of

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[235] Bankruptcy Act, §§ 157, 167(4), 191, 212, *supra*, nn. 229, 233, 184. *See Hearings before* Senate Judiciary Committee *on* H. R. 8046, 75th Cong., 2d Sess. (1937-38), *at* 127-8; *Report* No. 1916 *of* Senate Judiciary Committee *on* H. R. 8046 (1938), *at* 36.

[236] Bankruptcy Act, § 221(5); 11 U. S. C. § 621(5); 52 Stat. 897 (1938).

[237] *Leiman* v. *Guttman*, 336 U. S. 1 (1949, *per* DOUGLAS, *J.*); *Brown* v. *Gerdes*, 321 U. S. 178 (1944, *per* DOUGLAS, *J.*).

compensation (*e.g.*, indenture trustee) will have served before as well as during the proceedings; and he may expect to serve afterwards, too. His compensation may have been fixed by contract with the clients or class he represents; the contract may have been executed either before or during the proceedings; and he may be paid by his clients out of court, not by the trustee's disbursement.[238] Even if he applies to the Court at the winding-up for allowance under Article XIII, he may have a "consensual arrangement" with other persons interested in the estate, to avoid their objection; *e.g.*, his own clients may have an interest in the allowance of a large fee to him from the general estate where that fee will reduce the fee payable directly by his own clients out of their distributive share of the estate.[239] The parties' acquiescence in compensation applications is only evidentiary: "Every important determination by the court in receivership proceedings calls for an informed, independent judgment."[240]

The error below is the misconception of the force of contracts during Chapter X proceedings. *Any* contract which *may* diminish the estate, directly or indirectly, compels the judge's approval. The judge is an indispensable party to all contracts involving the estate; absent his approval, all such contracts are void.[241] He may authorize an *ordinary* course of business by the trustee or debtor, and excuse prior submission of routine to him, subject to accounting at the winding-up; and this may effect an estoppel of sorts in favor of

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[238] *Leiman* v. *Guttman*, *supra*, n. 237.

[239] *See Silbiger* v. *Prudence Bonds Corp.*, 180 F. 2d 917, *at* 923 (2d Cir., 1950, *per* L. HAND, *J.*), *cert. den.* 340 U. S. 813 (1950).

[240] *National Surety Co.* v. *Coriell*, 289 U. S. 426, *at* 436 (1933, *per* BRANDEIS, *J.*); *First National Bank of Cincinnati* v. *Flershem*, 290 U. S. 504, *at* 525 (1934, *per* BRANDEIS, *J.*). *See* 6 *Collier on Bankruptcy* ¶ 13.02; 3 *Id.* ¶ 62.05[3].

[241] Bankruptcy Act, §§ 116(2), (3); 11 U. S. C. §§ 516(2), (3); 52 Stat. 885 (1938). *See* 6 *Collier on Bankruptcy* ¶¶ 3.26, 3.27; *and see* Point B(3), *infra*.

third parties dealing with the trustee or debtor in possession: *e.g.*, wages to operational employees may be fixed and paid by the debtor's officers under the order authorizing the debtor to operate its business. But compensation to "fiduciaries"—including "officers"—is *extraordinary*, and does require the judge's prior approval. In effect, all service by "fiduciaries" in Chapter X proceedings remains subject to *quantum meruit*. There can be neither service nor compensation without "interposition by the court," regardless of "consensual arrangements."

Whether the § 221(4) requirement of "reasonableness" would permit re-negotiation of § 191 employment contract earlier judicially approved, on a complaint of incompetent performance, is immaterial here. What is material, is that the requirement of "reasonableness" is a requirement of "loyal and disinterested service," irrespective of competency. When service in Chapter X proceedings is not "loyal and disinterested," the employment contract is voidable and there can be no recovery in *quantum meruit*.[242]

6. Beneath the Court of Appeals' inference of Congressional intent, and the Court's election to construe § 249 strictly, are a reliance on principles of "general" equity and state law as the norm, and a disfavor of any deviation from those principles, even by Congress, even toward stricter fiduciary standards.

(a) Judge Friendly wrote that corporate managers, "despite their fiduciary obligations, had been free to buy or sell stock of the corporation before the Chapter X proceeding was contemplated" (R. 580), *i.e.*, under state law. In support of that proposition, Judge Friendly cited two decisions of this Court addressed to corporate recoupment of trading profits (not to denial of fiduciary compensation), and based on in-

[242] *Cf. U. S. v. Miss. Valley Generating Co.* ["*Dixon-Yates*"], 364 U. S. 520, *at* 564-5 (1961, *per* WARREN, *C. J.*).

herent chancery powers (not on legislation).[243] Implicit in that proposition are several presumptions, *viz.*: Corporate stock is not property *of* the corporation, so a corporate manager does not self-deal in entrusted property when he buys or sells stock. A corporate manager has only a *derivative* or indirect duty to the stockholders, since the scope of his duties extends only to the corporate property; he has no *direct* or express fiduciary duty to the stockholders, unlike (say) a protective committee representing the stockholders themselves; he is a *quasi*-trustee. A business corporation is normally not interested in buying its own stock in the market, and is indifferent to the identity of its stockholders (or even encourages stock purchases by its managers, for "incentive"); the availability of stock is not a "corporate opportunity." *Therefore*, the managers may buy and sell stock for their own accounts.

(b) Under state law, those presumptions are rebuttable; corporate managers are not absolutely "free" to trade in their corporation's securities. True, if the securities are not the subject of their trust, their liability would arise (if at all) at law, in fraud or deceit, upon misrepresentations to persons with whom they (like anyone else) were otherwise "free" to trade and compete. The persons aggrieved would be they alone who sold for too little or bought for too much. The suit would be for indemnity for actual loss incident to a misrepresentation in fact. But the corporate managers' liability to stockholders or the corporation would arise in equity where the managers had taken for themselves an "opportunity" in which their corporation was in fact "interested," or where they did have a direct obligation to the stockholders (*e.g.*, where they had sold "control" the proceeds of which they were bound to share with other stock-

[243] *S. E. C. v. Chenery Corp.*, 318 U. S. 80, *at* 88 (1943, *per* FRANKFURTER, J.) [*but see, after remand*, 332 U. S. 194 (1947, *per* MURPHY, J.)]; *Manufacturers Trust Co. v. Becker*, 338 U. S. 304, *at* 312-4 (1949, *per* CLARK, J.).

holders).[244] If the securities (or the "opportunity" therefor) become the subject of a trust, it is not simply the loss to the *cestuis* which must be indemnified; the fiduciary's personal profit in the transaction becomes an unjust enrichment subject to restitution. With the "express trust," the self-dealing is absolutely prohibited; restitution of all fruits will be decreed (profits *and* compensation) upon proof of self-dealing, *per se*.[245] Corporate "fiduciary" relationships are a hybrid "trust": the self-dealing is not absolutely prohibited; but, if the "opportunity" is the subject of the "trust" (*i.e.*, within the managers' duties), the burden of proof (including the risk of persuasion) shifts to the defendant-fiduciary to show that the transaction between corporation and manager carried the "earmarks of an arm's length bargain" between corporation and stranger,[246] or that the transaction between manager and stranger was one which the controlled corporation fairly would have declined to engage in for itself.

(c) Even in his own terms, Judge Friendly has overstated the respondents' case. The availability of the Debtor's stock was a "corporate opportunity," as a matter of (Pennsylvania) law. For an overissue has been outstanding since early 1953, before—and since—the reorganization was contemplated. If any stock-claimant here bought stock which the courts should ultimately void by reason of overissue, then—

> "• • • (a) if an identical security which does not constitute an overissue is reasonably available for purchase, the person entitled to issue or validation may

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[244] *See Southern Pacific Co.* v. *Bogert*, 250 U. S. 483 (1919, *per* BRANDEIS, *J.*); *Young* v. *Higbee Co.*, 324 U. S. 204 (1945, *per* BLACK, *J.*).

[245] *Michoud* v. *Girod*, 4 How. (45 U. S.) 503 (1846, *per* WAYNE, *J.*); *Magruder* v. *Drury*, 235 U. S. 106 (1914, *per* DAY, *J.*).

[246] *See Pepper* v. *Litton*, 308 U. S. 295, *at* 306-7 (1939, *per* DOUGLAS, *J.*).

compel the issuer [Debtor] to *purchase* and deliver such security to him * * *."[247]

Pennsylvania even authorizes a corporation to borrow in order to acquire its own shares.[248] Absent such "reasonably available" stock—in a rising market (as here)—the stock claimant could recover only his purchase price (paid between 1951 and 1953).[249]

If the same misconduct proved here had been committed *outside* a Chapter X proceeding, a state court might award the Debtor recovery of trading profits[250] (as well as recovery of diverted rents[251]) as against Weinstein and Fried. Indeed, in these Chapter X proceedings, the same misconduct may bring such relief, and may be judged by a state-like standard of proof: *i.e.*, liability may require further proof of actual overreaching by Weinstein and Fried and actual prejudice to their *cestuis*.[252] Under those standards, the court

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[247] 12A Purdon's Pa. Stats. Ann. [Uniform Commercial Code] § 8-104(a); P. L. 3, § 8-104(a) (1953), *as amended* P. L. 1023, § 8 (1959) (*emphasis supplied*). *See Prince* v. *Childs Co.*, 23 F. 2d 605, *at* 608 (2d Cir., 1928, *per* A. N. HAND, *J.*).

[248] Pa. Bus. Corp. L. § 302(8); 15 Purdon's Pa. Stats. Ann. § 2852-302(8); P. L. 364, Art. III, § 302(8), *amended* P. L. 711, § 1 (1957). *See Mulford*, Corporate Distributions to Shareholders and Other Amendments to Pa. Bus. Corp. Law, 106 U. Pa. L. Rev. 536, *at* 565-6 (1958).

[249] 12A Purdon's Pa. Stats. Ann. § 8-104(b), *supra*, n. 247.

[250] *See Bailey* v. *Jacobs*, 325 Pa. 187, 189 A. 320 (1937, *per* STERN, *J.*); *Lutherland, Inc.* v. *Dahlen*, 357 Pa. 143, 53 A. 2d 143 (1947, *per* STERN, *J.*); *Weissman* v. *A. Weissman, Inc.*, 374 Pa. 470, 97 A. 2d 870 (1953, *per* JONES, *J.*), 382 Pa. 189, 114 A. 2d 797 (1955, *per* CHIDSEY, *J.*); *Hozell* v. *McCloskey*, 375 Pa. 100, 99 A. 2d 610 (1953, *per* ARNOLD, *J.*).

[251] *See Rivoli Theatre Co., Inc.* v. *Allison*, 396 Pa. 343, 152 A. 2d 449 (1959, *per* BOK, *J.*); *Hempstead Theatre Corp.* v. *Metropolitan Playhouses, Inc.*, 6 N. Y. 2d 311, 189 N. Y. S. 2d 837 (1959, *per* FROESSEL, *J.*).

[252] *See* Bankruptcy Act, § 212, 11 U. S. C. § 612, 52 Stat. 895 (1938); *Mosser* v. *Darroze*, 341 U. S. 267 (1951, *per* JACKSON, *J.*); *Governor Clinton Co., Inc.* v. *Knott*, 120 F. 2d 149 (2d Cir., 1941, *per* CLARK, *J.*), *cert. dismd.* 314 U. S. 701 (1941); 6 *Collier on Bankruptcy* (14th ed.) ¶ 9.31.

might have to decide whether, years ago, the Debtor or any of its stockholders had sufficient funds and inclination to buy the stock which Weinstein and Fried bought, or would likewise have sold their stock at the same price (or whether, years ago, the Debtor might have made a better race-track lease with a stranger when Weinstein and Fried reduced Fried's rents and diverted another tenant's [LaGrotte's] rents from the Debtor to Fried). A state court might also deny compensation to Weinstein and Fried for the same misconduct, even though the evidence did not warrant restitution or indemnity.

> "* * * An agent is held to the utmost good faith in his dealings with his principal; if he acts adversely to his employer in any part of the transaction or omits to disclose any interest which would naturally influence his employer's conduct in dealing with the subject of employment, it is such a fraud upon his employer as forfeits any right to compensation for his services.* * *"[253]

And a state court might remove Weinstein and Fried from office.[254]

(d) Twentieth Century economic and social conditions require adaptation of Seventeenth Century principles of equity. The corporate "fiduciary" is a hybrid trustee. The equitable standards applicable to his relationships and conduct, have been continually adapted from the "express trust" as equity has taken cognizance of business matters; the sub-

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[253] *Beatty* v. *Guggenheim Exploration Co.*, 223 N. Y. 294, *at* 304, 119 N. E. 575 (1918, *per* CUDDEBACK, *J.*); *cf. s.c., rearg.*, 225 N. Y. 380, *at* 383, 122 N. E. 378 (1919, *per* CARDOZO, *J.*). *See Alleghany By-Products Coke Co.* v. *J. H. Hillman & Sons Co.*, 275 Pa. 191, 118 A. 906 (1922, *per* SADLER, *J.*); *Wendt* v. *Fischer*, 243 N. Y. 439, 154 N. E. 303 (1926, *per* CARDOZO, *C. J.*); *Elco Shoe Mfrs., Inc.* v. *Sisk*, 260 N. Y. 100, 183 N. E. 191 (1932, *per* POUND, *C. J.*).

[254] *See Markovitz* v. *Markovitz*, 336 Pa. 145, 8 A. 2d 46 (1939, *per* BARNES, *J.*); *People* v. *Lyon*, 119 A. D. 361, 104 N. Y. S. 319 (1st Dept., 1907, *per* SCOTT, *J.*).

jects of his "trust" have been expanded as business has grown in complexity. There is no perpetuity or sanctity in fixing corporate fiduciary standards *below* the fiduciary standards applicable to the express trustee, nor in limiting the subjects of a trust to property to which actual title or possession is delivered. The courts of equity have come to acknowledge that the hallmark of the fiduciary relationship is *power*, derived from and confided by a court and/or the beneficial owners of property.

> "* * * It is the fact of control of the common property held and exercised, not the particular means by which or manner in which the control is exercised, that creates the fiduciary obligation." [253]

Advisedly, Congress used the word "fiduciary"—not "trustee"—in § 249.

Any "fiduciary" serving in a Chapter X proceeding, must be satisfied with the reward of "reasonable compensation for services rendered"; there is no room for fringe benefits or side deals. What he takes which touches the estate, he must take for the class he serves. If a member, he receives his *aliquot* share of what his class of *cestuis* receive—and nothing more. If he is faithful, he earns fair and "reasonable compensation"; if he is not faithful, he forfeits all compensation. By denying compensation for disloyalty, Congress and the courts do not indemnify the *cestuis*, nor rectify an unjust enrichment; therefore, the "wrong" to a particular *cestui* is immaterial. It is the *conduct* by any "fiduciary" in the proceedings which is regulated. The particular consequences of his self-dealing or conflict of interest are immaterial to his eligibility for compensation. There is nothing new in equity in this. In § 249 and § 221(4) (as construed by *Woods*), Congress has stated facts and consequences. Its condemnation and mandate are entitled to the same judicial respect

[253] *Southern Pacific Co.* v. *Bogert*, 250 U. S. 483, *at* 487 (1919), *per* BRANDEIS, *J.*). *See* Pa. Bus. Corp. L. § 408; 15 Purdon's Pa. Stats. Ann. § 2852-408; P. L. 364, Art. IV, § 408 (1933).

as if Congress—or a judge—had attached a label of "trustee" relationship in traditional equity terms.

7. In sum: What other jurisdictions would do, is immaterial here. Immaterial, too, is what a Chapter X court would do if Wolf were seeking relief as against Weinstein and Fried other than denial of compensation and removal from office. Congress and this Court have spoken: § 249, § 221(4), and *Woods* mean precisely what they say. No exegesis—surely not respondents'—can subtract from the clear, cogent bar and mandate. The field is federally preempted. The federal standard for fiduciary compensation is simply higher and stricter than under comparable "general" equity or state law.

By statute, the Chapter X judge must approve all appointments and must approve all compensation. The jurisdiction over compensation is exclusive. Unless that exclusive jurisdiction over compensation carries with it the substantive fiduciary standards set by § 249 and § 221(4), the jurisdiction is hollow.

The double standard posited by the Court of Appeals is utterly inconsistent with the single and absolute standard which should be exacted of all fiduciaries in Chapter X proceedings, regardless of their mode of compensation and their mode of appointment. It is the *source of compensation*—the estate in judicial custody—which gives the Chapter X court exclusive jurisdiction over compensation *and* which should impose a single standard of conduct and compensation for all Chapter X fiduciaries.

B. Section 221(4) mandates denial of all compensation out of the estate to Weinstein and Fried, as Chapter X fiduciaries, in consequence of their diversions of the Debtor's rents to Fried during the proceedings.

Any actual conflict of interest—not alone trading in the Debtor's securities by a Chapter X fiduciary during the proceedings, brings a forfeiture of all compensation to him, pursuant to § 221(4). Here, Weinstein and Fried, in addition to trading in the Debtor's stock, engaged in a lengthy deliberate course of self-dealing, to the end of diverting the Debtor's rents during the proceedings into Fried's corporate pocketbook, Nazareth Enterprises, Inc. ("Enterprises"). The record shows Fried to have been the sole beneficiary of those diversions. Weinstein participated in the misconduct, but not in the fruits. (*See* pp. 36-41, *supra*.) Though it hardly matters under *Woods*, Weinstein was not disinterested: he was entangled with Fried in their common traffic in the Debtor's stock for much of the period of the rent diversions, including at least one occasion during that period when Weinstein acted as Fried's attorney-in-fact in Fried's purchases of shares. (*See* p. 35, *supra*.)

1. [257] The race-track matter has been relied on by Wolf in No. 26362 as alternative ground for denial of compensation and removal from office. The District Court denied part of the relief sought (recoupment of past compensation), and the Court of Appeals denied all; so, neither Court below made any findings or conclusions on the race-track matter. Where alternative grounds are alleged, the denial of relief on one ground requires a ruling—including findings and conclusions—on the alternative grounds.[257a]

2. The written race-track lease—unless and until modified, cancelled, or rejected by the Chapter X court—stands as

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[257] Rules 8(a), 52, F. R. Civ. P., *f.* 28 U. S. C. § 2072; *Sims v. Capitol Refrigeration Co., Inc.*, 294 F. 2d 111, *at* 115 (2d Cir. 1961, *per* WATERMAN, J.).

the instrument determining the rents due from Enterprises (Fried) to the Debtor during these proceedings. Section 116(3) authorizes new leases by a trustee or debtor in possession *only* upon the prior approval of the court.[258] Weinstein alone, *qua* president, had no independent power to make a new lease. Absent court approval, the change was void.[259] All rents withheld or diverted by reason of that void oral change in the race-track lease, were the Debtor's.

Respondents rely on *dictum* that § 116(3) permits sales and leases in the regular course of business of a debtor in possession, without prior judicial authorization—but only where the item involved is "trifling"; and the *dictum* continues, "No doubt any *unusual* contract would require express authorization, but *normal* purchases and sales would be permissible without a special order."[260] The race-track lease is not "trifling"; the change was a vastly new lease, and was not "normal." Of the Debtor's many written leases (not at will), the race-track lease is the *only* written lease ever changed by Weinstein and Fried in the nine years of these proceedings without prior judicial authorization (R. 473-4). No lease between the Debtor and Fried—while Fried was the Debtor's general manager—could be "usual" or "normal."

3. There is not, and never has been, a written agreement with LaGrotte or J&J covering the Nazareth race-track food-concession rents, notwithstanding the three written leases or licenses between the Debtor and LaGrotte and J&J covering the food-concession inside the Market. Absent a writing, the

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[258] Bankruptcy Act, § 116(3), 11 U. S. C. § 516(3), 52 Stat. 885 (1938).

[259] *See Wolf* v. *Nazareth Fair Grounds & Farmers' Market, Inc.*, 280 F. 2d 891 (2d Cir., 1960, *p.c.*); *In re American Cooler Co., Inc.* [*Standard Capital Corp.* v. *Safer*], 115 F. 2d 383 (2d Cir., 1940, *p.c.*), 125 F. 2d 496 (1942, *per* FRANK, *J.*); *In re Avorn Dress Co., Inc.*, 78 F. 2d 681, 79 F. 2d 337 (2d Cir., 1935, *per* SWAN, *J.*); 6 *Collier on Bankruptcy* ¶¶ 3.26, 3.27.

[260] *In re Avorn Dress Co., Inc., supra*, n. 259, 78 F. 2d *at* 681; *see* 6 *Collier on Bankruptcy* ¶ 3.27[2], *at* 730-1.

best evidence of an oral contract is the *practice* of the parties at the times in issue—here, in September of 1953, when these proceedings commenced, and during the months before and after, while LaGrotte paid *all* his rents to the Debtor, and none to Fried.[261] Fried claims those rents "belong" to him, under the race-track lease provision that increases the rent from 12% to 15% if "the *Lessee* operates the food concessions"; he claims he made a gift of the food-concession rents to the Debtor in 1953 and 1954. The "Lessee"—Enterprises—*never* operated the food concessions at the race-track; at all times, Fried licensed LaGrotte or J&J to operate them. There is no good reason to construe the race-track lease liberally in Fried's favor—*i.e.*, to interpret "Lessee" to mean "Lessee's subtenant or sublicensee"—when Fried drew the lease himself and had a conflict of interest at the time of execution. It is notorious that a food concession is often more valuable than the major lease itself; and the state courts, with their looser standards, have prevented percentage-lease differentials and side-deals from working frauds on landlords.[262] Absent a clear writing on the subject here, the race-track food concession was at least an "opportunity" belonging to the Debtor. Weinstein and Fried, the Debtor's managers, neither preserved the "opportunity" for the Debtor nor presented it to the Chapter X court.[263] They simply—and secretly—took it for Fried.

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[261] *Old Colony Trust Co. v. City of Omaha*, 230 U. S. 100, *at* 118 (1913, *per* VAN DEVANTER, *J.*); *N. Y. Central R. Co. v. N. Y., N. H. & Hartford R. Co.*, 24 Misc. 2d 414, 208 N. Y. S. 2d 605, *at* 617-8 (Sup., N. Y. 1960, *per* LORETO, *J.*), *aff'd* 13 A. D. 2d 809, 216 N. Y. S. 2d 928 (1st Dept., 1961, *per* RABIN, *J.*), *aff'd* 11 N. Y. 2d 1077, 230 N. Y. S. 2d 226 (1962); *Town of Islip v. Smith*, 3 A. D. 2d 726, 159 N. Y. S. 2d 763 (2d Dept., 1957, *p. c.*).

[262] *Ricoli Theatre Co., Inc. v. Allison*, 396 Pa. 343, 152 A. 2d 449 (1959, *per* BOK, *J.*); *Hempstead Theatre Corp. v. Metropolitan Playhouses, Inc.*, 6 N. Y. 2d 311, 189 N. Y. S. 2d 837 (1959, *per* FROESSEL, *J.*).

[263] *See Mosser v. Darrow*, 341 U. S. 267 (1951, *per* JACKSON, *J.*); *Donovan & Schuenke v. Sampsell*, 226 F. 2d 804 (9th Cir., 1955, *per* FEE, *J.*, *cert. den.* [*sub nom.*] *Freedman v. Donovan & Schuenke*, 350 U. S. 895 (1955); *In re Bridgeford Co.*, 287 F. 2d 182 (9th Cir., 1956, *per* SOLOMON, *D. J.*).

C. Weinstein and Fried are "fiduciaries" within the comprehension of § 249 and § 221(4).

Congress addressed § 249 to "*any* * * * *person* acting in the proceedings in a representative or *fiduciary* capacity." [264]

1. The words "representative" and "fiduciary" are not defined by the Bankruptcy Act, and comprehend a broad spectrum in equity. Their meaning depends upon *power* and *control*, not titles.

> "* * * * The majority has the right to control; but when it does, it occupies a fiduciary relation toward the minority; as much so as the corporation itself or its officers and directors. * * * *" [265]
>
> "* * * * It is the fact of control of the common property held and exercised, not the particular means by which or manner in which the control is exercised, that creates the fiduciary obligation." [266]

The bankruptcy courts, by statute and in equity, have steadfastly identified "fiduciaries" by their *functions; e.g.:*

> "* * * * There need be no formal relation of trust. *The disability grows out of the duty.* In our opinion the rule of equity should be so broadly applied as to embrace all persons who have a duty to perform with respect to the property of others and with the proper performance of whose duty the character of a purchaser of such property may be in any degree inconsistent." [267]

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[264] Bankruptcy Act, § 249; 11 U. S. C. § 649; 52 Stat. 901 (1938).

[265] *Southern Pacific Co.* v. *Bogert*, 250 U. S. 483, *at* 487-8 (1919, *per* BRANDEIS, *J.*).

[266] *Id.*, 250 U. S. *at* 492.

[267] *In re Erazin & Oppenheim*, 181 F. 307, *at* 309 (2d Cir., 1910, *per* NOYES, *J.*), *quoted in Donovan & Schuenke* v. *Campbell*, 226 F. 2d 804, *at* 810 (9th Cir., 1955, *per* FEE, *J.*), *cert. den.* [*sub nom. Freedman* v. *Donovan & Schuenke*], 350 U. S. 895 (1955). *See Pepper* v. *Litton*, 308 U. S. 295 (1939, *per* DOUGLAS, *J.*); *Governor Clinton Co., Inc.* v. *Knott*, 120 F. 2d 149 (2d Cir., 1941, *per* CLARK, *J.*), *cert. dismd.* 314 U. S. 701 (1941).

2. The statutory definitions in the Bankruptcy Act are likewise functional. A Chapter X debtor in possession is a corporate trustee; by statute, its powers and duties are assimilated to those of an individual trustee.[268] Necessarily, and as contemplated by the Bankruptcy Act,[269] much of Chapter X applies to the persons who control the Debtor — an artificial entity; *e.g.*, it is not the debtor in possession, but its officers, who receive compensation for services rendered.

Persons (referred to in § 249) are defined by § 1(23) to include *corporations*, and, in turn—

> "* * * when used with reference to the commission of acts which are forbidden under this Act shall include * * * *agents, officers*, * * *;"[270]

Officer is defined by § 1(22) to include *trustee*, and—

> "* * * the imposing of a duty upon, or the forbidding of an act by, any *officer* shall include * * * any *person* authorized by law to perform the duties of such officer;"[271]

Agent is not defined by the Bankruptcy Act.[272]

3. The orders of September 28, 1953, granting the Debtor's petition for Chapter X relief, provided that the Debtor "by Arnold A. Weinstein and Jerome Fried be authorized, directed and empowered to operate the business and manage the property of" the Debtor (R. 11-12, 15). Subsequent orders increasing Fried's salary were consistent. As

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[268] Bankruptcy Act, § 188, 11 U. S. C. § 588, 52 Stat. 892 (1938); *see* 6 *Collier on Bankruptcy* ¶ 8.10.

[269] *Pursuant to* Bankruptcy Act, § 102, 11 U. S. C. § 102, 52 Stat. 883 (1938), Chapters I *through* VII—including the definitions in § 1—are applicable under Chapter X unless inconsistent. *See* 6 *Collier on Bankruptcy* ¶¶ 1.01-1.12, 2.01-2.03.

[270] Bankruptcy Act, § 1(23); 11 U. S. C. § 1(23); 52 Stat. 840 (1938) (*emphasis supplied*). *See also* Bankruptcy Act, § 7b; 11 U. S. C. § 25b; 52 Stat. 847 (1938).

[271] Bankruptcy Act, § 1(22); 11 U. S. C. § 1(22); 52 Stat. 840 (1938) (*emphasis supplied*).

[272] *See U. S. v. Lynch*, 180 F. 2d 696 (7th Cir., 1950, *per* KERNER, J.), *cert. den.* 339 U. S. 981 (1950).

late as November 7, 1960, the District Judge's Conclusion of Law No. 2 stated: "For having traded in debtor's stock as aforesaid Weinstein's and Fried's management of the debtor should cease" (R. 252). The representations to the Court, made by Weinstein, Fried, and the Debtor's attorney, and upon which the aforesaid orders were made, alleged Fried's joint management with Weinstein, to justify Fried's salary of over $10,000 per year. And so the Debtor has been operated—jointly, by Weinstein and Fried—throughout these proceedings. (*See* pp. 32-33, *supra.*) Fried has been the classic "insider," with actual confidential information and control of the Debtor's business and value, both with respect to the Debtor's stock and the race-track lease and rents. Whether Fried was employed to operate the Debtor's business or to engage in litigation and negotiation relating to allowance of claims and new securities issues; whether Fried was employed by a debtor in possession or by an individual trustee; whether Fried was denominated an "additional trustee" or an "officer" or an "agent" or a "general manager"; whether Fried was paid weekly during the proceedings or in gross at the winding-up; these distinctions are formal only. Fried has been a *de facto* operating co-trustee with Weinstein, with management shared by them and frozen for years by the District Court.

The Bankruptcy Act and the bankruptcy courts forbid self-dealing in the Debtor's stock and in the Debtor's rents. The language of § 249—particularly the words "person" and "fiduciary"—and the language of § 221(4) are sweeping and unqualified. Within § 1(22) and § 1(23), Fried is an "officer" and "agent." Within § 241(3), Fried is an "officer" and "trustee" (*pace* Judge Friendly). Within § 249, he is a "person acting in the proceedings in a representative or fiduciary capacity." Within § 221(4), all payments made to "fiduciaries" must be "reasonable."[273]

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[273] Weinstein and Fried are "representatives" as well as "fiduciaries" under § 249; *see Finn* v. *Childs Co.*, 181 F. 2d 431, *at* 440-1 (2d Cir., 1950, *per* CLARK, *J.*); *cf. Young* v. *Higbee Co.*, 324 U. S. 204 (1945, *per* BLACK, *J.*).

D. The mandatory denial of future compensation out of the estate to Weinstein and Fried, also mandates their removal from office as president and director and as general manager (respectively) of the Debtor.

The Bankruptcy Act contains no explicit provision for removal of directors or officers of a Chapter X debtor in possession. The Court of Appeals did not reach the question (R. 577), though Judge Friendly stated, *obiter*, "we read § 188 as empowering the court to remove him [Philip, as director] if he should [obstruct the operation of the business]" (R. 583).

The District Court, after terminating the future compensation of Weinstein and Fried, barred them from participating in management, as a statutory condition of the Court's continuing the Debtor in possession, under § 188[275] (R. 494-5). However, for supposed lack of power, the District Judge declined to remove Weinstein from office (R. 249), adding the *dictum:*

> "* * * If I had the power, I would remove from office Mr. Weinstein as president because he traded in the stock. But I don't have the power. * * * " (R. 497)

(*See* Conclusion 1, R. 252). The District Judge's findings include:

> "4. The debtor's best interests require that it not be managed by persons serving without compensation." (R. 252)

Fried's "discharge" is more ambiguous. (*See* R. 495, 501-2, 244, 252.)

Evidently, the Court of Appeals disagreed: They permitted Weinstein and Fried to serve without pay for some 16 months, by granting a stay of the District Court's order

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[275] Bankruptcy Act, § 188; 11 U. S. C. § 588; 52 Stat. 892 (1938).

pending appeal; and they found no breach of trust or wrong by Weinstein or Fried (R. 576-7, 582).

The decree "barring Weinstein from participation in management," yet leaving him in office, effectually reduces the number of directors actively serving from three to two. Thus, while the Weinstein-Fried Group retain voting control of the Debtor and its Board, disagreement between Philip and Laupheimer *qua* directors results in one-man rule by Laupheimer *qua* vice-president. Moreover, the decree continues to expose to Weinstein the confidential information about the Debtor which he has already abused by insider trading.[276]

The Chapter X court is authorized, at any time, with or without cause, to terminate the debtor's possession, and to appoint a trustee.[277] Here, the District Judge declined to do so, notwithstanding the "suggestion" by the Court of Appeals (R. 245); and the Court of Appeals has not disturbed that District Court exercise of discretion. Termination of the Debtor's possession would not moot the question presented here; for the Debtor, even if put out of possession, would still represent the stockholders in these proceedings, and the capacity of its directors would remain in issue.[278]

On September 28, 1953, coincident with its continuing the Debtor in possession, the District Court stayed all proceedings against the Debtor in other courts[279] (R. 20). Removal of Weinstein and Fried must be sought in the Chapter X court. Sound discretion would scarcely give leave to proceed

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[276] *See Fells* v. *Katz*, 256 N. Y. 67, 175 N. E. 516 (1931), *per* POUND, *J.*).

[277] Bankruptcy Act, § 159; 11 U. S. C. § 559; 52 Stat. 888 (1938).

[278] *See* 6 *Collier on Bankruptcy* (14th ed.) ¶¶ 8.10, 8.11; *Report of* Percival E. Jackson, Counsel to Special Committee of U. S. Senate to Investigate Bankruptcy and Receivership Proceedings, *etc.*, Sen. Doc. No. 268, 74th Cong., 2d Sess. (1936), *at* 64.

[279] *Pursuant to* Bankruptcy Act, § 116(4); 11 U. S. C. § 516(4); 52 Stat. 885 (1938).

in a Pennsylvania state court, where the Chapter X court has—and is now exercising—exclusive jurisdiction over compensation and surcharge involving the identical facts and the identical parties.

1. *Powers:* The Chapter X court's power to remove directors and officers of a debtor in possession from office for misconduct, derives from both federal and state (Pennsylvania) law, alternatively. Federal law clearly supervenes:

> "§ 188. A debtor continued in possession of its property shall * * * exercise all the powers of a trustee * * *, subject, however, at all times to the control of the judge and to such limitations, restrictions, terms, and conditions as the judge may from time to time prescribe." [280]

However, comity and the Rules of Decision Act [281] require reference to domiciliary (Pennsylvania) law.

(a) As the private business corporation evolved, the law provided for removal of directors and officers for cause. Even in jurisdictions where the only statutory procedure was at "law," by writ of *quo warranto* brought by the state attorney-general (whether or not on a stockholder's relation), [282] concurrent jurisdiction lay in equity where the chancellor had already assumed valid jurisdiction over a corporation and the subject-matter (*e.g.*, in a derivative suit brought against corporate directors for an accounting for fraud, or where a receiver had been appointed). Equity then had the power to

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[280] Bankruptcy Act, § 188; 11 U. S. C. § 588; 52 Stat. 892 (1938).

[281] 28 U. S. C. § 1652, 62 Stat. 944 (1948).

[282] *See* Whyte v. *Faust*, 281 Pa. 444, 127 A. 234 (1924), *per* SCHAFFER, *J.*; *People* v. *Ballard*, 134 N. Y. 269, 32 N. E. 54 (1892), *per* VAN, *J.*, *reary. den.* 130 N. Y. 639, 32 N. E. 611 (1892), *p.* [illegible]; *see also U. S.* v. *Union Pacific R. R. Co.*, 98 U. S. 569 (1879), *per* MILLER, *J.*; *Ames* v. *Kansas*, 111 U. S. 449, *at* 469 (1884), *per* WAITE, *C. J.*; POUND, *Visitorial Jurisdiction over Corporations in Equity*, 49 Harv. L. Rev. 369 (1936).

decree, as "incidental relief," removal of directors and officers for cause.[283]

Now, by statute enacted in Pennsylvania in 1933,[284] equity has plenary jurisdiction over judicial removal of directors for cause. Stockholders having the most direct interest, may sue directly, without joining the attorney-general. Indeed, litigation is the only method to remove directors for cause in a situation like this, where cumulative voting would otherwise perpetuate office-holding. Pennsylvania law[285] and the Debtor's By-Laws[286] permit the board of directors to remove a corporate officer or agent at will, with or without cause. The Debtor's By-Laws are silent as to removal of directors. Pennsylvania law permits stockholders to remove directors at will, with or without cause—but subject to cumulative voting; *i.e.*, if those stockholders opposing removal of an individual director for cause, cast enough votes to have elected him by cumulative voting, then "amotion"[287] fails, and litigation is the only recourse.[288] However, the statute does not condition the accrual of the right of action upon attempted but unsuccessful amotion. The only adjective prerequisites relate to venue, joinder of the corporation, and the plaintiffs' shareholdings of 10% of the stock.[289]

Wolf's counsel has found no federal statutes or cases precisely in point.

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[283] *See Milasinovich* v. *Serbian Progressive Club, Inc.*, 369 Pa. 26, 84 A. 2d 571 (1951, *per* STEARNE, *J.*); *Deal* v. *Miller*, 245 Pa. 1, 90 A. 1070 (1914, *p.c.*); *Welcke* v. *Trageser*, 131 A. D. 731, 116 N. Y. S. 166 (1st Dept., 1909, *per* LAUGHLIN, *J.*).

[284] Pa. Bus. Corp. L. § 405; 15 Purdon's Pa. Stats. Ann. § 2852-405; P. L. 364, Art. IV, § 405 (1933).

[285] Pa. Bus. Corp. L. §§ 405(B), 407; 15 Purdon's Pa. Stats. Ann. §§ 2852-405(B), 407; P. L. 364, Art. IV, §§ 405(B), 407 (1933).

[286] Nazareth By-Laws, Art V, ¶ 3; Saul General Examiner's Exh. I; T. 168 [*not printed*].

[287] *See In re Koch*, 257 N. Y. 318, 178 N. E. 543 (1931 *per* KELLOGG, *J.*).

[288] Pa. Bus. Corp. L. § 405(A), *supra*, n. 284.

[289] Pa. Bus. Corp. L. § 405(C), *supra*, n. 284; *Markovitz* v. *Markovitz*, 336 Pa. 145, 8 A. 2d 46 (1939, *per* BARNES, *J.*).

(b) A debtor—whether or not in possession—must function normally *qua* corporation *during* the reorganization proceedings. Stockholder election of directors under the laws of the debtor's domicile is fundamental.[290] It can function in no other way. Moreover, the judge's own appointment of directors and officers of a debtor in possession, would be tantamount to appointment of trustees, and evasion of the statutory requirement of trustee "disinterestedness."[291] Unless and until the Chapter X court terminates the Debtor's possession here, it must provide stockholders with the rights correlative to election of directors and officers, *viz.:* removal for cause.

(c) Comity permits—and the Rules of Decision Act[292] compels—that the Chapter X court exercise at least the same powers over the Debtor's internal affairs as vested in the Pennsylvania court of common pleas by local statute. There is no inconsistency between state and federal law here. The Chapter X court has general equity jurisdiction. The Debtor is necessarily a party. Wolf holds more than 10% of the Debtor's stock (even under the Court of Appeals' decision in No. 27000). Moreover, he has independent standing as a stockholder, irrespective of the amount of his holdings, in Chapter X proceedings, by statute.[293] The Pennsylvania designation of venue does not oust or bar Chapter X jurisdiction.[294]

The substantive grounds for removal under Pennsylvania law—"fraudulent or dishonest acts, or gross abuse of author-

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[290] *In re J. P. Linahan, Inc.*, 111 F. 2d 596 (2d Cir., 1940, *per* PATTERSON, *J.*); *In re Bush Terminal Co.*, 78 F. 2d 662 (2d Cir., 1935, *per* MANTON, *J.*).

[291] *See* Bankruptcy Act, §§ 156, 158; 11 U. S. C. §§ 556, 558; 52 Stat. 888 (1938).

[292] 28 U. S. C. § 1652; 62 Stat. 944 (1948).

[293] *See* Bankruptcy Act, § 206; 11 U. S. C. § 606; 52 Stat. 894 (1938).

[294] *Mercer County* v. *Cozzles*, 7 Wall. (74 U. S.) 118 (1869, *per* CHASE, *C. J.*); *Chicot County* v. *Sherwood*, 148 U. S. 529 (1893, *per* JACKSON, *J.*).

ity or discretion with reference to the corporation".[295]—subsume the misconduct of directors and officers of a debtor in possession in Chapter X proceedings.

(d) In addition to general provision for equitable cognizance of removal of corporate directors and officers for cause, special provision is made, under the Pennsylvania Business Corporation Law, for honoring bankruptcy decrees that a corporation in reorganization "* * * constitute or appoint directors and officers in place of or in addition to all or some of the directors or officers then in office, * * *."[296]

(e) Apart from Pennsylvania law, the Chapter X court has sufficient statutory power to effect removal of directors and officers for cause. Narrowly, the power can be found in § 191: "* * * No person may become an officer or director of the debtor * * * without the prior approval of the court."[297] Since the District Judge must approve the commencement of service by a director or officer during the proceedings, he may modify or withdraw his earlier order of approval, certainly for cause, in order to "approve" or "control" the continuation of service. Moreover, § 221(5) requires the judge's approval of *prospective* management, even after the winding-up.[298] As contemplated by § 191, the stockholders retain the power of initial election, though subject to judicial veto—continuously.[299]

Broadly, the Chapter X court is vested by statute with the powers of an equity receivership court,[300] and to "Make such orders, * * * in addition to those specifically provided for, as may be necessary for enforcement of the provisions

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[295] Pa. Bus. Corp. L. § 405(C) (*supra*, n. 284).

[296] Pa. Bus. Corp. L. § 320(1), (2); 15 Purdon's Pa. Stats. Ann. § 320(1), (2); P. L. 364, Art. III, § 320(1), (2) (1939).

[297] Bankruptcy Act, § 191; 11 U. S. C. § 591; 52 Stat. 893 (1938).

[298] Bankruptcy Act, § 221(5); 11 U. S. C. § 621(5); 52 Stat. 897 (1938).

[299] *See* 6 *Collier on Bankruptcy* (14th Ed.) ¶ 8.15.

[300] Bankruptcy Act, § 115, 11 U. S. C. § 515; 52 Stat. 884 (1938).

of this Act * * * ",[301] and with the general power to exercise its jurisdiction by issuance of necessary writs.[302] If any doubt exists as to the Chapter X court's jurisdiction in equity, it may proceed as though on a writ of *quo warranto*, on Wolf's relation; and, under the modern federal procedure, Wolf's petition in No. 26362 is sufficient therefor.[303]

A serious Constitutional question would arise if the Chapter X court could preempt for itself, exclusively, such powers as a Pennsylvania state court (or federal diversity court) would have with respect to removal of corporate directors and officers for cause, yet deny *all* stockholder rights and remedies in that regard.[304] That question need not be reached here. The statutory "control" over a debtor in possession, and the equitable "visitorial power" over corporations, both vested in the Chapter X court, empower the court to adopt, adapt, and apply the domiciliary (Pennsylvania) law, *and* to "fashion federal law" where Chapter X is not explicit. The rest is a matter of propriety, not power.

2. *Propriety:* The principle underlying the denial of compensation pursuant to both § 249 and § 221(4), is the *Woods* paraphrase of *Paramount-Publix:*

> " * * * 'reasonable compensation for services rendered' necessarily implies loyal and disinterested service in the interest of those for whom the claimant purported to act." [305]

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[301] Bankruptcy Act, § 2a(15); 11 U. S. C. § 11a(15); 52 Stat. 842 (1938).

[302] All Writs Act, 28 U. S. C. § 1651, 62 Stat. 944 (1948).

[303] *See Continental Ill. Nat. Bank* v. *Chicago, R. I. & P. R. Co.*, 294 U. S. 648, *at* 675-6 (1935, *per* SUTHERLAND, *J.*) [§ 77]; 6 *Moore's Fed. Prac.* ¶ 54.10[5].

[304] *See Brinkerhoff-Faris Trust & S. Co.* v. *Hill*, 281 U. S. 673 (1930, *per* BRANDEIS, *J.*); *Graham* v. *Goodcell*, 282 U. S. 409 (1931, *per* HUGHES, *C. J.*); *Lynch* v. *U. S.*, 292 U. S. 571 (1934, *per* BRANDEIS, *J.*).

[305] *Woods* v. *City National Bank*, 312 U. S. 262, *at* 268 (1941, *per* DOUGLAS, *J.*).

The remedy for disloyalty is drastic. The purpose is preventive and prophylactic; to assure that the managers to whom the Chapter X judge and parties entrust the reorganization and the operation of the debtor's business during the proceedings, conduct themselves in a "disinterested" manner. Here, fiduciary misconduct has come to the attention of the court before the winding-up. To effectuate the purpose of "loyal and disinterested service" during the proceedings still to come, direct judicial removal from office is necessary and proper.[306]

E. The mandate of § 249 and § 221(4) comprehends compensation paid out of the estate in the past, and compels restitution by Weinstein and Fried.

Section 249 simply and absolutely directs, "*No* compensation * * * shall be allowed * * *." Section 221(4) conditions confirmation of a plan upon the "reasonableness" of "*all* payments *made or* promised by the debtor." By contrast, its predecessor, § 77B(f)(5), conditioned confirmation upon the "reasonableness" of "all amounts *to be* paid by the debtor." The *Woods* doctrine is faithful to the statutes. In short, the time of payment of compensation, and the time of application therefor, are irrelevant. If the misconduct occurs at any time during the proceedings, Chapter X prohibits all compensation for all services rendered at any time during the proceedings.

Here, the Debtor's weekly salary checks to Weinstein and Fried were signed by Weinstein as president and countersigned by Referee Joyce, pursuant to the District Judge's authorizing orders (R. 18). The Debtor continued to pay

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[306] *Cf.* 18 U. S. C. (Criminal Code) § 154, 62 Stat. 690 (1948): "* * * Whoever, being a * * * trustee, * * * or other officer of the court, knowingly purchases, directly or indirectly, any property of the estate * * * shall forfeit his office, * * *." *See* 2 *Collier on Bankruptcy* (14th ed.) ¶ 29.13.

those salaries after the occurrence of the misconduct (insider trading and rent diversions), after disclosure thereof to the Court, and after initiation of the proceedings on Wolf's petitions in No. 26362.

The judicial *power* to effectuate recoupment and restitution of moneys previously but improperly paid out of an estate, even under court order, has long been recognized and exercised by the bankruptcy courts, *e.g.*, where the recipient's disqualifying conduct had first been disclosed to the court after the payments were made, and where a court's mistake of law permitted continuation of payments even after disclosure of the disqualifying conduct.[307]

Ordinarily, § 249 and/or § 221(4) would be invoked at the winding-up, after a "fiduciary" had otherwise earned compensation for services already rendered and of value to the estate. Yet, denial of compensation for those years of valuable service, is precisely what Congress contemplated, and mandated. Here, the services were paid for weekly under § 191, instead of in gross at the winding-up. But there is no substantive difference in result: Restoring salaries paid by the Debtor (and perhaps invested wrongfully in the Debtor's stock) is no more penal than forfeiting the expectancy of compensation at the winding-up. Upon restitution, § 191 applicants and § 241 applicants occupy identical positions.

The time of denial of compensation—and the *need* for restitution—depend primarily upon the time of disclosure of the disqualifying conduct and the time of invoking the remedy. Weinstein and Fried themselves concealed their trading

[307] *In re H. L. Stratton, Inc.*, 51 F. 2d 984 (2d Cir., 1931, *per* A. N. HAND, *J.*), *cert. den.* [*sub nom. Jonas & Neuburger v. G. M. A. C.*] 284 U. S. 682 (1932); *In re International Match Corp.*, 190 F. 2d 458 (2d Cir., 1951, *per* A. N. HAND, *J.*), *cert. den.* [*sub nom. Ehrhorn v. International Match Realization Co., Ltd.*] 342 U. S. 870 (1951); *In re Stillwell*, 12 F. 2d 205 (6th Cir., 1926), *per* MOORMAN, *J.*); *In re DeRan*, 260 F. 732 (6th Cir., 1919, *per* KNAPPEN, *J.*).

in the Debtor's stock and their self-dealing in the race-track rents while they continued to draw their salaries. Wolf proceeded derivatively to terminate and recoup those salaries, in default of action by the Debtor (controlled by Weinstein); indeed, the Debtor affirmatively opposed Wolf's petitions in No. 26362. In view of their deliberate wrongdoing, their concealment of those wrongs, their use of the Debtor both to pay their own salaries and to oppose relief in the Debtor's behalf, and their own notice of their liability, there is no "equity" in relieving them of due restitution.

The determination of stock-claims is what this reorganization is all about. For Weinstein and Fried to traffic in those claims themselves at the moment they purport to act for the estate in choosing the good from the bad, is what § 249 aimed to prevent. For 20 years, the Courts of Appeals have rigorously applied § 249 while frequently observing that they viewed the result in particular cases as "harsh" or "tragic"; but the unbending principle, they said, was needed for future cases of willful and subtle self-dealing. The peculiar province of the federal courts having custody of an estate in reorganization, is to preserve that estate against the insider waste and depredation that necessitated the reorganization. This is the case for which § 249 had been so carefully preserved in the Circuits. This is the case for which § 221(4) and *Woods* were intended.

The Court of Appeals insisted that the law permitted the widest discretion; yet, the decisions below are largely *sub silencio*, and especially dubious in an appellate court acting on the cold written word and hot argument. Those *sub silencio* decisions compound the judicial failure below to respect the *objective* standards set for Chapter X fiduciaries by Congress and by this Court. This Court has repeatedly and cogently set forth those objective standards and the reasons for their objectivity. *E.g.:*

> "All the consideration which is paid for a bankrupt's assets becomes part of the estate. No device

or arrangement, however subtle, can subtract or divert any of it. It is the substance of the transaction not its form which governs. If that requirement were not rigidly enforced, control of the plan of reorganization and control of allowances, would pass from the court to the parties. That would subvert the statutory scheme." [308]

"* * * The motives of man are too complex for equity to separate in the case of its trustees the motive of acquiring efficient help from motives of favoring help, for any reason at all or from anticipation of counter-favors later to come. We think that which the trustee had no right to do he had no right to authorize, and that the transactions were as forbidden for the benefit of others as they would have been on behalf of the trustees himself.

"* * * But equity has sought to limit difficult and delicate fact-finding task concerning its own trustee by precluding such transactions for the reason that their effect is often difficult to trace, and the prohibition is not merely against injuring the estate—it is against profiting out of the position of trust. That this has occurred, so far as the employees are concerned, is undenied.

"* * * The most effective sanction for good administration is personal liability for the consequences of sion' of particular exceptions. * * *" [311]

The uncovering of fiduciary self-dealing demands the indignation of the chancellor, not the sophistication of the market-place.

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[308] *U. S.* v. *Knight*, 336 U. S. 505, *at* 508-9 (1949, *per* DOUGLAS, *J.*) [*conviction for embezzlement under 18 U. S. C. § 153*].

[309] *Mosser* v. *Darrow*, 341 U. S. 267, *at* 272-4 (1951, *per* JACKSON, *J.*) [*trustee surcharged $43,447.46 for employees' profits*].

"* * * Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exception.* * *" [311]

The reorganization legislation and its judicial applications of the 1930s and 1940s came in response to grave social ills. The disease and the purpose of a prophylactic policy may be forgotten when the policy has largely succeeded in arresting the disease. The germ lives, insidiously; witness *Nazareth*. More than a decade has passed since this Court last spoke on the subject of fiduciary compensation in Chapter X proceedings. This case is the occasion to affirm those principles yet again, lest silence from this Court for too long be viewed abroad as enervation and withdrawal.

Conclusion

In No. 27000, the Courts below applied federal rules of decision to a state question—the allowance of claims to stock interests which had vested under state law prior to federal reorganization. In No. 26362, the Courts below applied state rules of decision to a federal question—the administration during reorganization of an estate in the custody of a federal court. In No. 27000, the Courts below re-negotiated investment contracts made prior to the proceedings, without any fraud on the part of the contract-holders. In No. 26362, the Courts below refused to re-negotiate employment contracts made during the proceedings, though shown fraud on the part of the contract-holders. In both cases, the Court of Appeals set up classifications of pre-Chapter X investors and Chapter X employees which were irrational, arbitrary, and capricious. In both cases, the Courts below committed error.

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[311] *Meinhard* v. *Salmon*, 249 N. Y. 458, *at* 464, 164 N. E. 545 (1928, *per* CARDOZO, *C. J.*), *quoted in part in Woods* v. *City National Bank*, 312 U. S. 262, *at* 269 (1941, *per* DOUGLAS, *J.*). *Cf.* Friendly, *Reactions of a Lawyer—Newly Become Judge*, 71 Yale L. J. 218, *at* 237 (1961).

There is still a deeper error committed below in the choice of law. It was the choice of *no-law*; both the Court of Appeals and the District Court, variously in both cases, opted for unlimited judicial "discretion" in "equity." The quintessence of the opinions and decisions below is in Judge Moore's parenthesis: "the terminology is unimportant—the facts create the rights" (R. 592).

What Wolf urges here is not mere terminology, but law. It is *law* that creates the *rights*, here as elsewhere. Of course, litigants expect to be judged by men of decent instincts. Of course, life changes, and with it the law must change. But "rule of law, not rule of men"—a profound truism of our jurisprudence—requires that judges draw a line, somewhere in the gray, short of judgment by hazardous reading of character rather than conduct, short of judgment by nothing but decent instincts. It is justice, not grace, that Wolf prays for. The fundamental principles of Equity, the positive statutes of legislatures, the rulings of this Court—the law that *is*, found, like fact, by hard and humble search—must supersede the unbounded personal views of what should have been. Else, this Court seals a tyranny—and no less a tyranny for being judicial or ostensibly benevolent.

For the foregoing reasons, Petitioners Wolf *et al.* respectfully submit that the following relief should be granted by this Court:

No. 27000

1. Decretal paragraph 1 of the District Court's Judgment dated December 8, 1960, and entered December 9, 1960 (R. 262-3) should be modified to read as follows:

> "1. That each of the 36 stock-claimants hereafter named is the owner of shares of stock of Nazareth Fair Grounds & Farmers' Market, Inc., the Debtor herein, in such proportion to the total authorized issue

of 200 shares as his or her respective shares of stock (as represented by stock certificates outstanding and held by him or her) bears to the total outstanding issue of 262 shares of said Debtor's stock now held by said 36 stock-claimants in the aggregate; and, to that extent, each is deemed to be a stockholder of said Debtor for all purposes in the within reorganization proceeding, and is entitled to shares of stock of the Debtor calculated on that basis, *viz.:* Charles Kanter, 40/262; Morton Samet, 2/262; Gertrude Klein, 14/262; Dorothy Holober Clark, 3/262; Barry Clark, 4/262; Harold Q. Masur, 4/262; Louis Como, 6/262; Frank Como, 6/262; Patsy Como, 8/262; Anne Bikales, 5/262; Lawrence Treat, 2/262; Dorothy Kane, 3/262; Miriam Klein, 4/262; Ruth Spielholz, 3/262; Mae Bluestone, 2/262; Gussie Schwartz, 2/262; Harold B. Schwartz, 4/262; Lazar Karapontso, 2/262; Ernest Pollak, 9/262; H. Lawrence Laupheimer, 8/262; Arnold A. Weinstein, 7/262; Aaron Fried, 3/262; George Bond, 1/262; Tess J. Schwartz, 3/262; Cydney Grossman, 2/262; Rose Kaplan, 1/262; Robert A. Noire, 5/262; Harry Forman, 10/262; Richard S. Hull, 6/262; Herbert and Melvin Danciger, 11/262; Leslie Saul, 3/262; Jerome Fried, 3/262; Seymour Forman, 15/262; Eskander Manoochehrian, 20/262; Ann Rosen, 6/262; Frederick Katzenell, 35/262."

2. Decretal paragraphs 2, 3, 4, 5, and 6 of the District Court's aforesaid Judgment (R. 263-4) should be *affirmed*.

3. The Court of Appeals' Judgment, dated and entered November 9, 1961 (R. 600-1), should be *reversed* and *vacated*.

No. 26362

1. Arnold A. Weinstein and Jerome Fried should be removed from their respective offices as President and Director and as General Manager of Nazareth Fair Grounds & Farmers' Market, Inc., the Debtor herein, and should be barred from holding office as directors or officers or managers during the pendency of these reorganization proceedings.

2. Arnold A. Weinstein and Jerome Fried should be denied all compensation and reimbursement of expenses from said Debtor during the pendency of these reorganization proceedings.

3. Arnold A. Weinstein and Jerome Fried should severally account to the Chapter X court for all compensation and reimbursement of expenses received by them from said Debtor for the period from and after September 28, 1953; and each of them should restore to the Debtor, and the Debtor should recoup from each of them, all such compensation and reimbursement of expenses.

4. So much of the Court of Appeals' Judgment, dated and entered November 9, 1961 (R. 584-5), which reversed the District Court's Judgment dated June 14, 1960, and entered June 27, 1960 (R. 494-6), should be *reversed* and vacated.

Dated: New York, New York,
November 26, 1962.

Respectfully submitted,

MELVIN LLOYD ROBBINS,
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New York 16, N. Y.

APPENDIX A

Abstract of Federal Income Tax Returns and Accounting of Nazareth Enterprises, Inc.*

1953:	(a)	Gross spectator admissions	$ 48,243.92
	(b)	LaGrotte rents collected	0.00
	(c)	Net profit (loss)	(12,286.35)
	(d)	Rent to Debtor paid	5,668.27
	(e)	Net rents	5,668.27
1954:	(a)	Gross spectator admissions	$ 56,066.38
	(b)	J&J rents collected	875.65
	(c)	Net profit (loss)	(884.75)
	(d)	Rent to Debtor paid	6,503.60
	(e)	Net rents	5,627.95
1955:	(a)	Gross spectator admissions	$ 45,827.02
	(b)	J&J rents collected	4,346.62
	(c)	Net profit (loss)	(941.57)
	(d)	Rent to Debtor paid	5,946.22
	(e)	Net rents	1,599.60
1956:	(a)	Gross spectator admissions	$ 49,300.74
	(b)	J&J rents collected	3,638.92
	(c)	Net profit	1,074.15
	(d)	Rent to Debtor paid	5,708.64
	(e)	Net rents	2,069.72
1957:	(a)	Gross spectator admissions	$ 58,611.93
	(b)	J&J rents collected	4,606.48
	(c)	Net profit	7,026.18
	(d)	Rent to Debtor paid	6,638.53
	(e)	Net rents	2,032.05
1958.	(a)	Gross spectator admissions	$ 55,871.09
	(b)	J&J rents collected	3,348.66
	(c)	Net profit	3,700.36
	(d)	Rent to Debtor paid	5,852.11
	(e)	Net rent	2,503.45
1959:	(a)	Gross spectator admissions	$ 90,315.32
	(b)	J&J rents collected	5,235.62
	(c)	Net profit	2,334.53
	(d)	Rent to Debtor paid	9,300.36
	(e)	Net rent	4,064.74
1960:	(a)	Gross spectator admissions	$107,199.63
	(b)	J&J rents collected	7,245.35
	(c)	Net profit	?
	(d)	Rent to Debtor paid	11,224.07
	(e)	Net rent	3,978.72
1961:	(a)	Gross spectator admissions	$122,363.76
	(b)	J&J rents collected	?
	(c)	Net profit	?
	(d)	Rent to Debtor paid	12,663.07
	(e)	Net rent	?

Appendix A

* **Notes to Abstract.** (*See* Record on Pet. for Cert., No. 26302, vol. III.)

The information shown is obtained from: (1) Accounting of Nazareth Enterprises, Inc., dated and verified (by Jerome Fried, as President) on January 9, 1962, and filed in the District Court for the Southern District of New York on January 10, 1962; (2) Enterprises' federal income tax returns (J. Fried Creditor: Debtor's Exhs. AB, AC, AD, AE, AF; Wolf's Exhs. 45, 46); (3) Enterprises' journals and ledgers (J. Fried Creditor: Cl.'s Exh. 7; Wolf's Exhs. 47, 48); and (4) Gilbert Sunshine's testimony (S. M. 11/18/60, 11788-99), based on his worksheets and the aforesaid records. Mr. Sunshine is Enterprises' accountant; he is also the accountant for the Debtor and for J&J Foods, Inc. (S. M. 1/26/60, 10051-3, 10062-4). He prepared the tax returns, and supervised the Enterprises bookkeeping. (The testimony and exhibits and Accounting referred to, have not been printed.)

This Abstract shows: (a) Gross spectator admissions at the Enterprises box-office (excluding taxes and the back-gate receipts); (b) Rents collected by Enterprises from LaGrotte and J&J; (c) Net taxable operating profit (or loss), earned (or incurred) by Enterprises; (d) Percentage rents paid by Enterprises to the Debtor; (e) Net rents (i.e., difference between (d) Enterprises rents paid to the Debtor, and (b) rents collected by Enterprises from LaGrotte and J&J). The years shown are the calendar years 1953 through 1961; the Enterprises annual racing season (except for Tuesday "drag races") extends from about May 1 to October 31.

Enterprises' fiscal year runs from March 1 to February 28. The tax return for fiscal 1961 (3/1/60-2/28/61) is not in evidence.

No federal income tax was paid by Enterprises from fiscal 1954 through fiscal 1959 (inclusive): In fiscal 1954, 1955, and 1956, Enterprises showed net losses; and in fiscal 1957, 1958, and 1959, the loss carry-forward consumed the net operating profits shown. Enterprises paid federal income tax of $6.77 for fiscal 1960.

In fiscal 1954 and 1960, Fried received $1,500 and $5,200 (respectively) from Enterprises as officer's compensation. No such compensation to Fried is shown for fiscal 1955 through 1959 (inclusive).

Enterprises' federal income tax for fiscal 1954 (J. Fried creditor: Debtor's AC) shows "netted rents" (i.e., the difference between the rent paid by Enterprises to the Debtor, and the rent collected by Entrprises from J&J (S. M. 11/18/60, 11845-52). If this practice had been followed on later Enterprises' returns, then item (e) "Net rents" would have appeared on these returns, instead of both item (d) Rent to Debtor paid, and item (b) J&J rent collected (*see* S. M. 11/18/60, 11789).

Appendix A

In the calendar years 1958 and 1959, J&J paid Enterprises, in rent, 15% of its (J&J's) gross receipts on its race-track food concession sales of $15,260.08 and $19,385.78 (respectively) (Wolf's 26), which equalled $2,289.01 and $2,907.87 (respectively) (S. M. 10455-8). The tax returns show that Enterprises collected $3,348.66 and $5,235.62 in "rents" from J&J in 1958 and 1959 (respectively). The difference arises from Enterprises' 50% share of J&J's net profit on its race-track sales (S. M. 11/18/60, 11769-70, 11871-5, 11913-7), which equalled $1,059.65 and $2,327.75 in 1958 and 1959 (respectively).

Following is a tabulation of the "Gate," the gross spectator admissions at the Enterprises box-office (excluding taxes and the back-gate receipts), and the actual percentage rents paid by Enterprises to the Debtor, and a computation of rents at 12% and 15% of the "Gate":

	Gate	*12%*	*15%*	*Actual*	*Actual*
1953	$ 48,243.92	$ 5,789.27	$	$ 5,668.27	11.749%
1954	56,066.38	6,727.97	8,409.96	6,503.50	11.560%
1955	45,827.02	5,499.24	6,874.05	5,946.22	12.975%
1956	49,300.74	5,915.09	7,395.11	5,708.64	11.579%
1957	58,611.93	7,033.43	8,791.79	6,638.53	11.326%
1958	55,871.09	6,704.53	8,380.66	5,852.11	10.474%
1959	90,315.32	10,837.84	13,547.30	9,300.36	10.298%
1960	107,199.63	12,863.96	16,079.94	11,224.07	10.470%
1961	122,363.76	14,863.65	18,354.56	12,663.07	10.349%
Total (1954-61)	$585,555.87	$70,265.71	$87,833.37	$63,836.50	10.902%

Appendix A

Following is a tabulation of the amounts which would be *due* from Enterprises to the Debtor, under the Enterprises lease: (a) if Enterprises were required to pay over to the Debtor the J&J rents which Enterprises collected, *and* to pay the Debtor rent at 12%; and, (b) if Enterprises were permitted to retain the J&J rents it collected, but if Enterprises were required to pay the Debtor rent at 15%:

	(a) 12% + J&J	*Due*	*(b) 15%*	*Due*
* 1954	$ 7,603.62	$ 1,100.02	$ 8,409.96	$ 1,906.36
1955	9,845.86	3,899.64	6,874.05	927.83
1956	9,555.01	3,846.37	7,395.11	1,686.47
1957	11,639.91	5,001.38	8,791.79	2,153.26
1958	10,053.49	4,201.08	8,380.66	2,528.55
1959	16,073.46	6,773.10	13,547.30	4,246.94
1960	20,109.31	8,885.24	16,079.94	4,855.87
1961	?	?	18,354.56	5,691.49
Total	$84,880.36	$33,706.83	$87,833.37	$23,996.77

* Enterprises collected the J&J race-track food-concession rents for only part of 1954. However, Sunshine is unable to break down the totals or to ascertain when in 1954 the change was made. (S. M. 11/18/60, 11795-9, 11845-51.)

APPENDIX B

Text of Statutes Cited

Bankruptcy Act, §§ 1(22), 1(23); 11 U.S.C. §§ 1(22), 1(23); 52 Stat. 840 (1938):

§ 1. *Meaning of Words and Phrases*

The words and phrases used in this Act and in proceedings pursuant hereto shall, unless the same be inconsistent with the context, be construed as follows: * * *

(22) "Officer" shall include clerk, marshal, receiver, custodian, referee, and trustee, and the imposing of a duty upon, or the forbidding of an act by, any officer shall include his successor and any person authorized by law to perform the duties of such officer;

(23) "Persons" shall include corporations, except where otherwise specified, and officers, partnerships, and women, and when used with reference to the commission of acts which are forbidden under this Act shall include persons who are participants in the forbidden acts, and the agents, officers, and members of the board of directors or trustees or of other similar controlling bodies of corporations; * * *.

Bankruptcy Act, § 2a(15); 11 U.S.C. § 11a(15); 52 Stat. 842 (1938):

§ 2. *Creation of courts of bankruptcy and their jurisdiction*

a. The courts of the United States hereinbefore defined as courts of bankruptcy are created courts of bankruptcy and are invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this title, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

* * *

(15) Make such orders, issue such process, and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this title: *Provided, however*, That an injunction to restrain a court may be issued by the judge only.

* * *

Bankruptcy Act, § 7b; 11 U.S.C. § 25b; 52 Stat. 847 (1938):

§ 7. *Duties of bankrupts*

a. * * *

b. Where bankrupt is a corporation, its officers, the members of its board of directors or trustees or of other similar controlling bodies, its stockholders or members, or such of them as may be designated by the court, shall perform the duties imposed upon the bankrupt by this title.

Bankruptcy Act, § 115, 11 U.S.C. § 515; 52 Stat. 884 (1938):

§ 115. *Same; Jurisdiction as in Insolvency*

Upon the approval of a petition, the court shall have and may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon it, exercise all the powers, not inconsistent with the provisions of this chapter, which a court of the United States would have if it had appointed a receiver in equity of the property of the debtor on the ground of insolvency or inability to meet its debts as they mature.

Appendix B

Bankruptcy Act, § 116; 11 U.S.C. § 516; 52 Stat. 885 (1938):

§ 116. *Same; Additional Jurisdiction over Administration of Estate* —

Upon the approval of a petition, the judge may, in addition to the jurisdiction, powers and duties hereinabove and elsewhere in this chapter conferred and imposed upon him and the court—

(1) permit the rejection of executory contracts of the debtor, except contracts in the public authority, upon notice to the parties to such contracts and to such other parties in interest as the judge may designate;

(2) authorize a receiver, trustee, or debtor in possession, upon such notice as the judge may prescribe and upon cause shown, to issue certificates of indebtedness for cash, property, or other consideration approved by the judge, upon such terms and conditions and with such security and priority in payment over existing obligations, secured or unsecured, as in the particular case may be equitable;

(3) authorize a receiver or a trustee or a debtor in possession, upon such notice as the judge may prescribe and upon cause shown, to lease or sell any property of the debtor, whether real or personal, upon such terms and conditions as the judge may approve; and

(4) in addition to the relief provided by section 11 [11 U. S. C. § 29] of this Act, enjoin or stay until final decree the commencement or continuation of a suit against the debtor or its trustee or any act or proceeding to enforce a lien upon the property of the debtor.

(5) * * *

Appendix B

Bankruptcy Act, § 156; 11 U.S.C. § 356; 52 Stat. 888 (1938):

§ 156. *Appointment of Trustees; Continuance of Debtor in Possession*

Upon the approval of a petition, the judge shall, if the indebtedness of a debtor, liquidated as to amount and not contingent as to liability, is $250,000 or over, appoint one or more trustees. Any trustee appointed under this chapter shall be disinterested and shall have the qualifications prescribed in section 45 of this Act, except that the trustee need not reside or have his office within the district. If such indebtedness is less than $250,000, the judge may appoint one or more such trustees or he may continue the debtor in possession. In any case where a trustee is appointed, the judge may, for the purposes specified in section 189 of this Act, appoint as an additional trustee a person who is a director, officer, or employee of the debtor.

Bankruptcy Act, § 157; 11 U.S.C. § 357; 52 Stat. 888 (1938):

§ 157. *Attorney for Trustee*

An attorney appointed to represent a trustee under this chapter shall also be a disinterested person: *Provided, however,* That for any specified purposes other than to represent a trustee in conducting the proceeding under this chapter the trustee may, with the approval of the judge, employ an attorney who is not disinterested.

Bankruptcy Act, § 158; 11 U.S.C. § 358; 52 Stat. 888 (1938):

§ 158. *Interest of Persons*

A person shall not be deemed disinterested, for the purposes of section 156 and section 157 of this Act, if—

(1) he is a creditor or stockholder of the debtor; or

(2) he is or was an underwriter of any of the outstanding securities of the debtor or within five years prior to the date of the filing of the petition was the underwriter of any securities of the debtor; or

(3) he is, or was within two years prior to the date of the filing of the petition, a director, officer, or employee of the debtor or any such underwriter, or an attorney for the debtor or such underwriter; or

(4) it appears that he has, by reason of any other direct or indirect relationship to, connection with, or interest in the debtor or such underwriter, or for any reason an interest materially adverse to the interests of any class of creditors or stockholders.

Bankruptcy Act, § 159; 11 U.S.C. § 559; 52 Stat. 888 (1938):

§ 159. *Termination of trustee's appointment or debtor's possession.*

Where the indebtedness of a debtor is less than $250,000, the judge may at any time terminate the appointment of a trustee and restore the debtor to the possession of its property, or, if the debtor has been continued in possession, terminate its possession and appoint a trustee.

Bankruptcy Act, § 160; 11 U.S.C. § 560; 52 Stat. 888 (1938):

§ 160. *Appointment of additional trustees; removal and substitution of trustees.*

In any case, the judge at any time, without or upon cause shown, may appoint additional trustees or remove trustees and appoint substitute trustees.

Appendix B

Bankruptcy Act § 167; 11 U.S.C. § 567; 52 Stat. 890 (1938):

§ 167. *Powers and duties; trustee.*

The trustee upon his appointment and qualification—

(1) shall, if the judge shall so direct, forthwith investigate the acts, conduct, property, liabilities, and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, and any other matter relevant to the proceeding or to the formulation of a plan, and report thereon to the judge;

(2) may, if the judge shall so direct, examine the directors and officers of the debtor and any other witnesses concerning the foregoing matters or any of them;

(3) shall report to the judge any facts ascertained by him pertaining to fraud, misconduct, mismanagement and irregularities, and to any causes of action available to the estate;

(4) may, subject to the approval of the judge, employ such person or persons as the judge may deem necessary for the purpose of assisting the trustee in performing the duties imposed upon him under this chapter;

(5) shall, at the earliest date practicable, prepare and submit a brief statement of his investigation of the property, liabilities, and financial condition of the debtor, the operation of its business and the desirability of the continuance thereof, in such form and manner as the judge may direct, to the creditors, stockholders, indenture trustees, the Securities and Exchange Commission, and such other persons as the judge may designate; and

(6) shall give notice to the creditors and stockholders that they may submit to him suggestions for the formulation of a plan, or proposals in the form of plans, within a time therein named.

Bankruptcy Act, § 168; 11 U.S.C. § 568; 52 Stat. 890 (1938):

§ 168. *Same; Disinterested Person Where Debtor is in Possession*

If a debtor is continued in possession, the judge may at any time appoint a disinterested person as examiner to prepare and file a plan and to perform the duties imposed upon a trustee under paragraphs (1) to (5) inclusive, of section 167 of this Act, or to perform any of such duties.

Bankruptcy Act, § 188; 11 U.S.C. § 588; 52 Stat. 892 (1938):

§ 188. *Debtor in possession; title, rights, duties, and powers*

A debtor continued in possession of its property shall have all the title, be vested with all the rights, be subject to all the duties, and exercise all the powers of a trustee appointed under this chapter, subject, however, at all times to the control of the judge and to such limitations, restrictions, terms, and conditions as the judge may from time to time prescribe.

Bankruptcy Act, § 191; 11 U.S.C. § 591; 52 Stat. 893 (1938):

§ 191. *Employment of Officers of Debtor*

A trustee or debtor in possession may employ officers of the debtor at rates of compensation to be approved by the court. No person shall become an officer or director of the debtor, to fill a vacancy or otherwise, without the prior approval of the court.

Appendix B

Bankruptcy Act, § 196; 11 U.S.C. § 596; 52 Stat. 893 (1938):

§ 196. *Filing and Allowing Proofs of Claims; Objections to Allowances*

After the approval of the petition the judge shall prescribe the manner in which and fix a time within which the proofs of claim of creditors and of the interests of stockholders may be filed and allowed. Objections by any party in interest to the allowance of any such claims or interests shall be heard and summarily determined by the Court.

Bankruptcy Act § 206; 11 U.S.C. § 606; 52 Stat. 894 (1938):

§ 206. *Persons entitled to hearings.*

The debtor, the indenture trustees, and any creditor or stockholder of the debtor shall have the right to be heard on all matters arising in a proceeding under this chapter. The judge may, for cause shown, permit a labor union or employees' association, representative of employees of the debtor, to be heard on the economic soundess of the plan affecting the interests of the employees.

Bankruptcy Act § 210; 11 U.S.C. § 610; 52 Stat. 895 (1938):

§ 210. [*Representation in Proceedings*]; *statement by attorney.*

An attorney for creditors or stockholders shall not be heard unless he has first filed with the court a statement setting forth the names and addresses of such creditors or stockholders, the nature and amounts of their claims or stock, and the time of acquisition thereof, except as to claims or stock alleged to have been acquired more than one year prior to the filing of the petition.

Appendix B

Bankruptcy Act, § 212; 11 U.S.C. § 612; 52 Stat. 895 (1938):

§ 212. *Same; Regulation by Court*

The judge may examine and disregard any provision of a deposit agreement, proxy, power or warrant of attorney, trust mortgage, trust indenture, or deed of trust, or committee or other authorization, by the terms of which an agent, attorney, indenture trustee, or committee purports to represent any creditor or stockholder, may enforce an accounting thereunder, may restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claim or stock acquired by such person or committee in contemplation or in the course of the proceeding under this chapter to the actual consideration paid therefor.

Bankruptcy Act, § 221(4); 11 U.S.C. § 621(4); 52 Stat. 897 (1938):

§ 221. *Confirmation by Court*

The judge shall confirm a plan if satisfied that— • • •

(4) all payments made or promised by the debtor or by a corporation issuing securities or acquiring property under the plan or by any other person, for services and for costs and expenses in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable or, if to be fixed after confirmation of the plan, will be subject to the approval of the judge; • • •.

Appendix B

Bankruptcy Act § 241; 11 U.S.C. § 641; 52 Stat. 900 (1938):

§ 241. *Petitioning creditors; court officers; attorneys therefor.*

The judge may allow reimbursement for proper costs and expenses incurred by the petitioning creditors and reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in a proceeding under this chapter—

(1) by a referee;

(2) by a special master;

(3) by the trustee and other officers, and the attorneys for any of them;

(4) by the attorney for the debtor; and

(5) by the attorney for the petitioning creditors.

Such compensation of referees and trustee shall not be governed by sections 40 and 48 [11 U. S. C. §§ 68 and 76] of this Act.

Bankruptcy Act, § 247; 11 U.S.C. § 647; 52 Stat. 901 (1938):

§ 247. *Hearing of applications*

The judge shall fix a time of hearing for the consideration of applications for allowances, of which hearing notice shall be given to the applicants, the trustee, the debtor, the creditors, stockholders, indenture trustees, the Securities and Exchange Commission, and such other persons as the judge may designate, ***. ***

Bankruptcy Act, § 249; 11 U.S.C. § 649; 52 Stat. 901 (1938):

§ 249. *Statement of Claims or Stock Acquired or Transferred after Commencement of Proceeding*

Any persons seeking compensation for services rendered or reimbursement for costs and expenses incurred in a proceeding under this chapter shall file with the court a state-

ment under oath showing the claims against, or stock of, the debtor, if any, in which a beneficial interest, direct or indirect, has been acquired or transferred by him or for his account, after the commencement of such proceeding. No compensation or reimbursement shall be allowed to any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold such claims or stock, or by whom or for whose account such claims or stock have, without the prior consent or subsequent approval of the judge, been otherwise acquired or transferred.

Amendatory Act, § 5b; Additional Provisions of the Act of June 22, 1938 (The Chandler Act, ch. 575, 52 Stat. 840), § 5b; 11 U.S.C. § 1, notes:

§ 5. *Severability; Headings*

• • •

b. Sections and subdivision headings shall not be taken to govern or limit the scope of the sections or subdivisions to which they relate.

Bankruptcy Act, § 77B(b); 11 U.S.C. § 207(b); 48 Stat. 915 (1934) [*Repealed*]:

§ 77B(b) [*Repealed*]. A plan of reorganization within the meaning of this section • • •: *Provided*, That the judge shall scrutinize and may disregard any limitations or provisions of any depositary agreements, trust indentures, committee or other authorizations affecting any creditor acting under this section and may enforce an accounting thereunder or restrain the exercise of any power which he finds to be unfair or not consistent with public policy and may limit any claims filed by such committee member or agent, to the actual consideration paid therefor. • • •

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Bankruptcy Act, § 77B(c): 11 U.S.C. § 207(c): 48 Stat. 912 (1934) [*Repealed*]:

§ 77B(c) [*Repealed*] Upon approving the petition or answer or at any time thereafter, the judge, in addition to the jurisdiction and powers elsewhere in this section conferred upon him, * * *

(9) may allow a reasonable compensation for the services rendered and reimbursement for the actual and necessary expenses *incurred* in connection with the proceeding and the plan by officers, parties in interest, depositaries, reorganization managers and committees or other representatives of creditors or stockholders, and the attorneys or agents of any of the foregoing and of the debtor, but appeals from orders fixing such allowances may be taken to the Circuit Court of Appeals independently of other appeals in the proceeding and shall be heard summarily; * * *

While the debtor is in possession (a) its officers shall be entitled to receive only such reasonable compensation as the judge shall from time to time approve, and (b) no person shall be elected or appointed to any office, to fill a vacancy or otherwise, without the prior approval of the judge.

Bankruptcy Act, § 77B(f)(5): 11 U.S.C. §207(f)(5): 48 Stat. 912 (1934):

§ 77B(f) [*Repealed*] After hearing such objections as may be made to the plan, the judge shall confirm the plan if satisfied that * * *

(5) all amounts to be paid by the debtor or by any corporation or corporations acquiring the debtor's assets, and all amounts to be paid to committees or reorganization

managers, whether or not by the debtor or any such corporation for services or expenses incident to the reorganization, have been fully disclosed and are reasonable, or are to be subject to the approval of the judge; * * *.

Securities Exchange Act of 1934, § 16(b); 15 U.S.C. § 78p(b); 48 Stat. 896 (1934):

§ 16. *Directors, officers, and principal stockholders.*

(a) * * *

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or official by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase

and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

(c) * * *

18 U.S.C. [Criminal Code] § 153; 62 Stat. 690 (1948):

§ 153. *Embezzlement by trustee, receiver or officer.*

Whoever knowingly and fraudulently appropriates to his own use, embezzles, spends, or transfers any property or secretes or destroys any document belonging to the estate of a bankrupt which came into his charge as trustee, receiver, custodian, marshal, or other officer of the court, shall be fined not more than $5,000 or imprisoned not more than five years, or both.

18 U.S.C. [Criminal Code] § 154; 62 Stat. 690 (1948):

§ 154. *Adverse interest and conduct of referees and other officers.*

* * *

Whoever, being a referee, receiver, custodian, trustee, marshal, or other officer of the court, knowingly purchases, directly or indirectly, any property of the estate of which he is such officer in a bankruptcy proceeding;

* * *

Shall be fined not more than $500, and shall forfeit his office, which shall thereupon become vacant.

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28 U.S.C. § 1651; 62 Stat. 944 (1948), *amended* 63 Stat. 102 (1949):

§ 1651. *Writs*

(a) The Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law.

(b) An alternative writ or rule nisi may be issued by a justice or judge of a court which has jurisdiction.

28 U.S.C. § 1652; 62 Stat. 944 (1948):

§ 1652. *State laws as rules of decision*

The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in *civil actions* [trials at common law] in the courts of the United States, in cases where they apply. [*Italicized words substituted for bracketed words* by 1948 amendment to Judiciary Act of 1789, § 34; 1 Stat. 92, Rev. Stat. § 721, 28 U. S. C. [1940 ed.] § 725.]

Rules 1, 2, 52(a), 81(a)(1), Fed. Rules of Civ. Proc., *f.* 28 U.S.C. § 2072:

Rule 1. *Scope of Rules.*

These rules govern the procedure in the United States district courts in all suits of a civil nature whether cognizable as cases at law or in equity, with the exceptions stated in Rule 81. They shall be construed to secure the just, speedy, and inexpensive determination of every action.

Rule 2. *One Form of Action.*

There shall be one form of action to be known as "civil action."

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Rule 52. ***Findings by the Court***

(a) EFFECT. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41(b).

Rule 81. ***Applicability in General.***

(a) *To What Proceedings Applicable.*

(1) These rules do not apply to proceedings in admiralty. They do not apply to proceedings in bankruptcy or proceedings in copyright under Title 17, U.S.C., except in so far as they may be made applicable thereto by rules promulgated by the Supreme Court of the United States. They do not apply to probate, adoption, or lunacy proceedings in the United States District Court for the District of Columbia except to appeals therein.

* * *

Appendix B

General Orders in Bankruptcy

37.—General Provisions

In proceedings under the Act the Rules of Civil Procedure for the District Courts of the United States shall, in so far as they are not inconsistent with the Act or with these general orders, be followed as nearly as may be. But the court may shorten the limitations of time prescribed so as to expedite hearings, and may otherwise modify the rules for the preparation or hearing of any particular proceeding.

Pa. Constitution, Art. XVI, § 7 (1874):

§ 7. *Stocks and bonds; increase of indebtedness*

No corporation shall issue stocks or bonds except for money, labor done, or money or property actually received; and all fictitious increase of stock or indebtedness shall be void. The stock and indebtedness of corporations shall not be increased except in pursuance of general law, *nor without the consent of the persons holding the larger amount in value of the stock, first obtained at a meeting to be held after sixty days notice in pursuance of law.* [*Italicized words deleted by 1956 amendment.*]

Pa. Bus. Corp. L. § 302(8); 15 Purdon's Pa. Stats. Ann. § 2852-302(8); P.L. 364, Art. III, § 302(8) (1933), amended by P.L. 711, § 1 (1957):

§ 302. *General powers*

Subject to the limitations and restrictions contained in this act or in its articles, every business corporation shall have power:

• • •

(8) To borrow money for any or all of the purposes for which it is organized, to issue its promissory notes, bonds, or

other forms of certificates of indebtedness, [for the repayment thereof, with interest] *for money, labor done, or money or property, including shares of the corporation properly acquirable by it under this act, actually received* and to secure any of its obligations by mortgage, pledge, or deed of trust of, or on, any of its property, franchises and income.

[*Italicized words added, and bracketed words deleted, by 1957 amendment.*]

Pa. Bus. Corp. L. § 320(1), (2): 15 Purdon's Pa. Stats. Ann. § 2852-302(1), (2); P.L. 364, Art. III, § 320(1), (2) (1933), *added* P.L. 698, § 1 (1939), *amended* P.L. 711, § 1 (1957):

§ 320. *Arrangement, and reorganization under National Bankruptcy Act*

(1) Any business corporation having a plan of reorganization or an arrangement which, pursuant to the provisions of the Act of Congress of July first, one thousand eight hundred and ninety-eight, entitled "An act to establish a uniform system of bankruptcy throughout the United States," as amended and supplemented, or of any similar Act of Congress (said act and such acts being herein referred to as the National Bankruptcy Act), has been or shall be confirmed by the decree or order of a court of competent jurisdiction, shall have full power and authority to put into effect and carry out the plan or arrangement and the decrees and orders of the court, or judge or referee relative thereto, and may take any proceeding and do any act provided in the plan or arrangement or directed by such decrees and orders, without further action by its directors or shareholders. Such power and authority may be exercised, and such proceedings and acts may be taken, as may be directed by such decrees or orders, by the trustee or trustees, or receiver or receivers, of such corporation appointed in the bankruptcy proceed-

ings (or a majority thereof), or if none be appointed and acting, by designated officers of the corporation, or by a master or other representative appointed by the court or judge or referee, with like effect as if exercised and taken by unanimous action of the directors and shareholders of the corporation [but a business corporation shall not increase its indebtedness or its authorized capital stock except after the approval of such increase at a meeting of its shareholders held in accordance with the provisions of this act].

(2) Such corporation may, in the manner above provided, but without limiting the generality or effect of the foregoing, alter, amend, or repeal its by-laws; constitute or reconstitute and classify or reclassify its board or directors, and name, constitute or appoint directors and officers in place of or in addition to all or some of the directors or officers then in office; amend its articles of incorporation, and make any change in its stated capital [or authorized capital stock], or any other amendment, change, alteration, or provision, authorized by this act, including the cancellation of any or all authorized classes of shares, whether or not any shares thereof are outstanding; be dissolved, transfer all or part of its assets, merge or consolidate as permitted by this act, in which case, however, no shareholder shall have any statutory right of appraisal of his shares; change the location of its principal office; authorize and fix the terms, manner and conditions of the issuance of bonds, debentures or other obligations, whether or not convertible into [stock] *shares* of any class, or bearing warrants or other evidences of optional rights to purchase or subscribe for [stock] *shares* of any class; or lease its property and franchises to any corporation, if permitted by law.

* * *

[*Italicized words added, and bracketed words deleted, by 1957 amendment.*]

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Pa. Bus. Corp. L. § 405; 15 Purdon's Pa. Stats. Ann. § 2852-405; P.L. 364, Art. IV, § 405 (1933):

§ 405. *Removal of directors*

A. The entire board of directors or any individual director may be removed from office without assigning any cause by a majority vote of the holders of the outstanding shares entitled to vote at an election of directors. In case the board or any one or more directors be so removed, new directors may be elected at the same meeting. Unless the entire board be removed, no individual director shall be removed in case the votes of a sufficient number of shares are cast against the resolution for his removal, which if cumulatively voted at an election of the full board would be sufficient to elect one or more directors.

B. The board of directors may declare vacant the office of a director if he be declared of unsound mind by an order of court, or convicted of felony, or for any other proper cause, or if, within sixty days or such other time as the by-laws may specify, after notice of his election, he does not accept such office either in writing or by attending a meeting of the board of directors and fulfill such other requirements of qualification as the by-laws may specify.

C. The court of common pleas of the county where the registered office of the corporation is located may at the suit of any shareholder or shareholders holding at least ten per cent of the common or outstanding shares, with or without voting rights, remove from office any director or directors in case of fraudulent or dishonest acts, or gross abuse of authority or discretion with reference to the corporation, and may bar from re-election any director so removed for a period prescribed by the court. The corporation shall be made a party to such actions.

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Pa. Bus. Corp. L. § 407; 15 Purdon's Pa. Stats. Ann. § 2852-407; P.L. 364, Art. IV, § 407 (1933):

§ 407. *Removal of officers*

Any officer or agent elected or appointed by the board of directors may be removed by the board of directors whenever in its judgment the best interests of the corporation will be served thereby, but such removal shall be without prejudice to the contract rights, if any, of the person so removed.

Pa. Bus. Corp. L. § 408; 15 Purdon's Pa. Stats. Ann. § 2852-408; P.L. 364, Art. IV, § 408 (1933):

§ 408. *Relation of directors and officers to corporation*

Officers and directors shall be deemed to stand in a fiduciary relation to the corporation, and shall discharge the duties of their respective positions in good faith and with that diligence, care and skill which ordinary prudent men would exercise under similar circumstances in their personal business affairs.

Pa. Bus. Corp. L. § 603A; 15 Purdon's Pa. Stats. Ann. § 2852-603A; P.L. 364, Art. VI, § 603A (1933), *amended by* P.L. 711, § 1 (1957):

§ 603. *Consideration for shares*

A. Shares of a business corporation shall not be issued except for money, labor done, or money or property actually received. Subscriptions for shares having a par value shall be made payable with money to an amount not less than the aggregate par value of the shares subscribed for or with consideration other than money, the fair value of which to the corporation is not less than the aggregate par value of the

shares subscribed for. Subscriptions for shares having no par value, which are made before incorporation, shall be made payable with consideration of the character and value determined by the incorporators. Subscriptions for shares having no par value, which are made after incorporation, shall be made payable with consideration of the character and value determined by the shareholders at any annual or special meeting duly called and held for that purpose, or determined by the board of directors, acting under authority conferred by the shareholders or by the articles of the corporation. Shares of a corporation issued and thereafter acquired by it may be disposed of by the corporation for such consideration as may be fixed from time to time by the board of directors. For the purpose of determining whether shares have been fully paid for, in order to fix the extent of the outstanding obligation of a shareholder to the corporation with respect to such shares, the value placed by the incorporators, the shareholders, or the board of directors, as the case may be, upon the consideration, other than cash, with which the subscriptions for shares are made payable, shall be conclusive.

* * *

Pa. Bus. Corp. L. § 604; 15 Purdon's Pa. Stats. Ann. § 2852-604; P.L. 364, Art. VI, § 604 (1933):

§ 604. *Payment of Subscriptions for Shares*

Unless otherwise provided in the subscription agreement, subscriptions for shares, whether made before or after the organization of a corporation, shall be paid in full at such time, or in such installments and at such times, as shall be determined by the board of directors. Any call made by the board of directors for payment of subscriptions shall be uniform as to all shares of the same class, or as to all shares of the same series, as the case may be. The director shall cause notice of the amount of any call, and of the time and place

of payment, to be given at least thirty days before the date the call is due, either personally or by mail addressed to each shareholder at his last address, as it appears on the books of the corporation. If a shareholder be indebted to a business corporation on account of unpaid subscriptions for shares, the corporation shall have a lien upon such shares for such indebtedness. Shares for which the agreed consideration has been paid, delivered, or rendered to the corporation shall be fully paid shares and non-assessable. No note or obligation given by a shareholder, whether secured by pledge or otherwise, shall be considered as payment, in whole or in part, of any shares of a business corporation.

Pa. Bus. Corp. L. § 605; 15 Purdon's Pa. Stats. Ann. § 2852-605; P.L. 364, Art. VI, § 605 (1933):

§ 605. *Defaults in Payment of Consideration for Shares*

When any shareholder fails to pay any call upon his shares properly made by the directors, at the time when such payment is due, the directors may proceed to collect the amount due in the same manner as any debt due the corporation, or they may sell, at public sale, such part of the shares of the delinquent shareholder as will pay all or any part of the installments then due from him, with interest and all incidental expenses, and transfer the shares so sold to the purchaser, who shall be entitled to a certificate therefor. Notice of the time and place of such sale, and of the sum due on each share, shall be given by advertisement, once a week for two consecutive weeks next preceding the date fixed for the sale, in a newspaper of general circulation published in the county where the corporation has its registered office and in the legal newspaper, if any, designated by the rules of court for the publication of legal notices in such county, or, if there be no newspaper of

general circulation published in such county, then in a newspaper of general circulation in such county, and such notice shall be mailed by the treasurer of the corporation to the delinquent shareholder, at his last known post office address, at least twenty days before the date fixed for such sale. If no bidder can be had to pay the amount due on the shares, or if the amount is not collected by an action at law brought within the county where such corporation has its registered office, the shares shall be forfeited to the corporation, and the amount previously paid in by the delinquent shareholder on the shares shall be forfeited to the corporation. Such shares, if forfeited, may be reissued or reoffered for subscription by the corporation. No share shall be voted at any meeting upon which any installment is due and unpaid.

Pa. Bus. Corp. L. § 609: 15 Purdon's Pa. Stats. Ann. § 2852-609; P.L. 364, Art. VI, § 609 (1933):

§ 609. *Liability of Subscribers and Shareholders*

A subscriber to, or holder of, shares of a corporation formed under this act shall not be under any liability to the corporation with respect to such shares, other than the obligation of complying with the terms of the subscription for such shares. Any person becoming an assignee or transferee of shares, or of a subscription for shares, in good faith and without knowledge or notice that the full consideration therefor has not been paid, shall not be personally liable to the corporation or its creditors for any unpaid portion of such consideration. No person holding shares as executor, administrator, guardian, trustee, receiver, or in any other representative or fiduciary capacity, shall be personally liable as a shareholder by reason of so holding such shares, but the estate and funds in the hands of such fiduciary or representative shall be so liable. No pledgee or

other holder of shares as collateral security shall be personally liable as a shareholder, but the person pledging such shares shall be considered the holder thereof and shall be liable as a shareholder.

Pa. Bus. Corp. L. § 610; 15 Purdon's Pa. Stats. Ann. § 2852-610; P.L. 364, Art. VI, § 610 (1933):

§ 610. *Validity of Shares*

The fact that shares are issued in violation of, or without full compliance with, the provisions of this act shall not make the shares so issued invalid, unless they are issued in violation of Article XVI, Section seven, of the Constitution of this Commonwealth.

Pa. Bus. Corp. L. § 701: 15 Purdon's Pa. Stats. Ann. § 2852-701; P.L. 364, Art. VII, § 701 (1933), *amended* P.L. 1123, § 1 (1935), *amended* P.L. 711, § 1 (1957):

§ 701. [*Directors may declare dividends*

A. [Subject to the restrictions contained in the articles of the corporation and the provisions of this article, any business corporation, by its board of directors, may declare and pay dividends upon the outstanding shares of the corporation out of its surplus, as hereinafter provided, from time to time and to such extent as the board of directors may deem advisable. Dividends may be paid in cash, in property, or in shares of the corporation, but no corporation shall pay dividends:

[(1) In cash or property, except from the surplus of the aggregate of its assets over the aggregate of its liabilities, including in the latter the amount of its stated capital, after deducting from such aggregate of its assets the amount by which such aggregate was increased by unrealized appreciation in value or revaluation of fixed assets, unless the amount

thereof shall have been transferred to, or included in, its stated capital.

[(2) • • •

B. [In computing the aggregate of the assets of the corporation, the board of directors shall determine and make proper allowance for depreciation and depletion sustained, and losses of every character, except as otherwise provided in this section. Deferred assets and prepaid expenses shall be written off at least annually in proportion to their use, as may be determined by the board of directors. Amounts of surplus arising from an unrealized appreciation or revaluation of fixed assets shall be shown on the books of the corporation as a separate item apart from surplus profits or paid-in surplus.]

C. • • •

[*Foregoing repealed in 1957; see new § 704.*]

Pa. Bus. Corp. L. § 704B; 15 Purdon's Pa. Stats. Ann. § 2852-704B; P.L. 364, Art. VII, § 704 (1933), *amended* P.L. 331, § 1 (1951), P.L. 711, § 1 (1957):

§ 704. *Special provisions relating to surplus and reserves*

A. • • •

B. The portion, if any, of the capital surplus of a business corporation arising from revaluation of or unrealized appreciation in assets may be decreased, from time to time, by resolution of the board of directors, directing such decrease and an equal decrease in the book value of such assets. Upon the realization of any such increase in value, the board of directors may, by resolution, transfer from capital surplus to earned surplus the amount realized.

• • •

[*Entire § 704B newly enacted in 1957; see former § 701A, B.*]

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N. Y. Pers. Prop. L. (40 McKinney's N. Y. Consol. L.) § 33; L. 1934, c. 142; *subd. 3 added by* L. 1941, c. 331, § 3, *amended by* L. 1943, c. 5, L. 1944, c. 588, § 5; *subd. 4 added by* L. 1941, c. 330, § 3, *amended by* L. 1944, c. 588, § 5.

§ 33. *Validity of certain agreements made without consideration*

1. An agreement for the purchase, sale, transfer or delivery of a certificate or other evidence of debt, issued by the United States or by any state, or a municipal or other corporation, or of any share or interest in the stock of any bank corporation or joint stock association, incorporated or organized under the laws of the United States or of any state, is not void or voidable, for want of consideration, or because of the non-payment of consideration, or because the vendor, at the time of making such contract, is not the owner or possessor of the certificate or certificates or other evidence of debt, share or interest.

* * *

3. A promise hereafter made in writing and signed by the promisor or by his agent shall not be denied effect as a valid contractual obligation on the ground that consideration for the promise is past or executed, if the consideration is expressed in the writing and is proved to have been given or performed and would be a valid consideration but for the time when it was given or performed.

4. An assignment hereafter made shall not be denied the effect of irrevocably transferring the assignor's rights because of the absence of consideration, if such assignment is in writing and signed by the assignor, or by his agent.

* * *

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N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) § 86; 69 Purdon's Pa. Stats. Ann. § 61, P.L. 543, § 5 (1915) [*Repealed*]; Uniform Sales Act, § 5:

§ 86. *Existing and future goods*

1. The goods which form the subject of a contract to sell may be either existing goods, owned or possessed by the seller, or goods to be manufactured or acquired by the seller after the making of the contract to sell, in this article called "future goods."

2. There may be a contract to sell goods, the acquisition of which by the seller depends upon a contingency which may or may not happen.

3. Where the parties purport to effect a present sale of future goods, the agreement operates as a contract to sell the goods.

N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) § 87; 69 Purdon's Pa. Stats. Ann. § 62, P.L. 543, § 6 (1915) [*Repealed*]; Uniform Sales Act, § 6:

§ 87. *Undivided shares*

1. There may be a contract to sell or a sale of an undivided share of goods. If the parties intend to effect a present sale, the buyer, by force of the agreement, becomes an owner in common with the owner or owners of the remaining shares.

2. In the case of fungible goods, there may be a sale of an undivided share of a specific mass, though the seller purports to sell and the buyer to buy a definite number, weight or measure of the goods in the mass is undetermined. By such a sale the buyer becomes owner in common of such

a share of the mass as the number, weight or measure bought bears to the number, weight or measure of the mass. If the mass contains less than the number, weight or measure bought, the buyer becomes the owner of the whole mass and the seller is bound to make good the deficiency from similar goods unless a contrary intent appears.

N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) § 98; 69 Purdon's Pa. Stats. Ann. § 141, P.L. 543, § 17 (1915) [*Repealed*]; Uniform Sales Act, § 17:

§ 98. *No property passes until goods are ascertained*

Where there is a contract to sell unascertained goods no property in the goods is transferred to the buyer unless and until the goods are ascertained, but property in an undivided share of ascertained goods may be transferred as provided in section eighty-seven [P. S. § 62; U. S. A. § 6].

N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) § 99; 69 Purdon's Pa. Stats. Ann. § 142, P.L. 543, § 18 (1915) [*Repealed*]; Uniform Sales Act, § 18:

§ 99. *Property in specific goods passes when parties so intend*

1. Where there is a contract to sell specific or ascertained goods, the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred.

2. For the purpose of ascertaining the intention of the parties, regard shall be had to the terms of the contract, the conduct of the parties, usages of trade and the circumstances of the case.

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N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) § 100; 69 Purdon's Pa. Stats. Ann. § 143, P.L. 543, § 19 (1915) [*Repealed*]; Uniform Sales Act, § 19:

§ 100. *Rules for ascertaining intention*

Unless a different intention appears, the following are rules for ascertaining the intention of the parties as to the time at which the property in the goods is to pass to the buyer.

* * *

Rule 2. Where there is a contract to sell specific goods and the seller is bound to do something to the goods, for the purpose of putting them into a deliverable state, the property does not pass until such thing be done.

* * *

Rule 4. 1. Where there is a contract to sell unascertained or future goods by description, and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer, or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be expressed or implied, and may be given either before or after the appropriation is made.

* * *

N. Y. Pers. Prop. L. (L. 1911, c. 571) (40 McKinney's N. Y. Consol. L.) § 156(1); 69 Purdon's Pa. Stats. Ann. § 337(1), P.L. 543, § 76(1) (1915) [*Repealed*]; Uniform Sales Act, § 76(1):

§ 156. *Definitions*

1. In this article, unless the context or subject-matter otherwise requires:

* * *

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"Fungible goods" means goods of which any unit is from its nature or by mercantile usage treated as the equivalent of any other unit.

* * *

"Value" is any consideration sufficient to support a simple contract. An antecedent or pre-existing claim, whether for money or not, constitutes value where goods or documents of title are taken either in satisfaction thereof or as security therefor.

* * * *

N. Y. Pers. Prop. L. (L. 1913, c. 600) (40 McKinney's N. Y. Consol. L.) § 162; 15 Purdon's Pa. Stats. Ann. § 301, P.L. 126, § 1 (1911) [*Repealed*]; Uniform Stock Transfer Act, § 1:

§ 162. *How title to certificates and shares may be transferred.*

Title to a certificate and to the shares represented thereby can be transferred only,

(a) By delivery of the certificate indorsed either in blank or to a specified person by the person appearing by the certificate to be the owner of the shares represented thereby, or

(b) By delivery of the certificate and a separate document containing a written assignment of the certificate or a power of attorney to sell, assign or transfer the same or the shares represented thereby, signed by the person appearing by the certificate to be the owner of the shares represented thereby. Such assignment or power of attorney may be either in blank or to a specified person.

(c) *By delivery of a separate instrument containing a written assignment of the certificate, or an interest therein, executed by the officer who levies an execution against property upon such certificate, or such interest therein, and sells*

the same, to the purchaser on the execution sale, and such assignment shall, together with delivery of the certificate, effect a transfer of the title to the certificate, or the interest therein levied upon and sold as specified in such assignment, and the shares represented by such certificate, or such interest therein, to the purchaser at the execution sale.

The provisions of this section shall be applicable although the charter or articles of incorporation or code of regulations or by laws of the corporation issuing the certificate and the certificate itself provide that the shares represented thereby shall be transferable only on the books of the corporation or shall be registered by a registrar or transferred by a transfer agent.

[*Italicized words added to New York statute only*, L. 1936, c. 153, § 2.]

N. Y. Pers. Prop. L. (L. 1913, c. 600) (40 McKinney's N. Y. Consol. L.) § 164; 15 Purdon's Pa. Stats. Ann. § 303, P.L. 126, § 3 (1911) [*Repealed*]; Uniform Stock Transfer Act, § 3:

§ 164. *Corporation not forbidden to treat registered holder as owner*

Nothing in this article or in article 6-A shall be construed as forbidding a corporation,

(a) To recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner, or

(b) To hold liable for calls and assessments a person registered on its books as the owner of shares.

[*Italicized words added to New York statute only*, L. 1962, c. 839, § 1.]

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N. Y. Pers. Prop. L. (L. 1913, c. 600) (40 McKinney's N. Y. Consol. L.) § 165; 15 Purdon's Pa. Stats. Ann. § 304, P.L. 126, § 4 (1911) [*Repealed*]; Uniform Stock Transfer Act, § 4:

§ 165. *Title derived from certificate extinguishes title derived from a separate document*

The title of a transferee of a certificate under a power of attorney or assignment not written upon the certificate, and the title of any person claiming under such transferee, shall cease and determine if, at any time prior to the surrender of the certificate to the corporation issuing it, another person, for value in good faith, and without notice of the prior transfer, shall purchase and obtain delivery of such certificate with the indorsement of the person appearing by the certificate to be the owner thereof, or shall purchase and obtain delivery of such certificate and the written assignment or power of attorney of such person, though contained in a separate document.

N. Y. Pers. Prop. L. (L. 1913, c. 600) (40 McKinney's N. Y. Consol. L.) § 171; 15 Purdon's Pa. Stats. Ann. § 310, P.L. 126, § 10 (1911) [*Repealed*]; Uniform Stock Transfer Act, § 10:

§ 315. *Lien of corporation and restrictions on transfer*

There shall be no lien in favor of a corporation upon the shares represented by a certificate issued by such corporation, and there shall be no restriction upon the transfer of shares so represented, by virtue of any by-law of such corporation, or otherwise, unless the right of the corporation to such lien or the restriction is stated upon the certificate.

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N. Y. Pers. Prop. L. (L. 1913, c. 600) (40 McKinney's N. Y. Consol. L.) § 176; 15 Purdon's Pa. Stats. Ann. § 315, P.L. 126, § 15 (1911) [*Repealed*]; Uniform Stock Transfer Act, § 15:

§ 176. *There shall be no lien or restriction unless indicated on certificates*

There shall be no lien in favor of a corporation upon the shares represented by a certificate issued by such corporation and there shall be no restriction upon the transfer of shares so represented by virtue of any by-law of such corporation, or otherwise, unless the right of the corporation to such lien or the restriction is stated upon the certificate.

N. Y. Pers. Prop. L. (L. 1913, c. 600) (40 McKinney's N. Y. Consol. L.) § 179; 15 Purdon's Pa. Stats. Ann. § 318, P.L. 126, § 18 (1911) [*Repealed*]; Uniform Stock Transfer Act, § 18:

§ 179. *Rule for cases not provided for by this article*

In any case not provided for by this article, the rules of law and equity, including the law merchant, and in particular the rules relating to the law of principal and agent, executors, administrators and trustees, and to the effect of fraud, misrepresentation, duress or coercion, mistake, bankruptcy or other invalidating cause, shall govern.

N. Y. Pers. Prop. L. (L. 1913, c. 600) (40 McKinney's N. Y. Consol. L.) § 183; 15 Purdon's Pa. Stats. Ann. § 322, P.L. 126, § 22 (1911) [*Repealed*]; Uniform Stock Transfer Act, § 22:

§ 183. *Other definitions*

1. In this article, unless the context or subject-matter otherwise requires—

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"Certificate' means a certificate of stock in a corporation organized under the laws of this state or of another state whose laws are consistent with this article.

"Delivery" means voluntary transfer of possession from one person to another.

"Person" includes a corporation or partnership or two or more persons having a joint or common interest.

To "purchase" includes to take as mortgagee or as pledgee.

"Purchaser" includes mortgagee and pledgee.

"Shares" means a share or share of stock in a corporation organized under the laws of this state or of another state whose laws are consisted with this article.

"State" includes state, territory, district and insular possession of the United States.

"Transfer" means transfer of legal title.

"Title" means legal title and does not include a merely equitable or beneficial ownership or interest.

"Value" is any consideration sufficient to support a simple contract. An antecedent or pre-existing obligation, whether for money or not, constitutes value where a certificate is taken either in satisfaction thereof or as security therefor.

2. A thing is done "in good faith" within the meaning of this article, when it is in fact done honestly, whether it be done negligently or not.

12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code) § 1-105; P.L. 3, § 1-105 (1953), *amended P.L.* 1023, § 1 (1959):

§ 1-105. ***Territorial Application of the Act; Parties' Power to Choose Applicable Law***

(1) Except as provided hereafter in this section, when a transaction bears a reasonable relation to this state and also

to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties. Failing such agreement this Act applies to transactions bearing an appropriate relation to this state.

(2) Where one of the following provisions of this Act specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) so specified:

* * *

Applicability of the Article on Investment Securities. Section 8-106.

* * *

12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code) § 2-105; P.L. 3, § 2-105 (1953):

§ 2-105. *Definitions: Transferability; "Goods"; "Future" Goods; "Lot"; "Commercial Unit"*

(1) * * *

(2) Goods must be both existing and identified before any interest in them can pass. Goods which are not both existing and identified are "future" goods. A purported present sale of future goods or of any interest therein operates as a contract to sell.

(3) There may be a sale of a part interest in existing identified goods.

(4) An undivided share in an identified bulk of fungible goods is sufficiently identified to be sold although the quantity of the bulk is not determined. Any agreed proportion of such a bulk or any quantity thereof agreed upon by number, weight or other measure may to the extent of the seller's interest in the bulk be sold to the buyer who then becomes an owner in common.

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12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code) § 8-103; P.L. 3, § 8-103 (1953):

§ 8-103. *Issuer's Lien*

A lien upon a security in favor of an issuer thereof is valid against a purchaser only if the right of the issuer to such lien is set forth conspicuously on the security.

12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code) § 8-104; P.L. 3, § 8-104 (1953), *amended* P.L. 1023, § 8 (1959):

§ 8-104. *Effect of Overissue; "Overissue"*

(1) The provisions of this Article which validate a security or compel its issue or reissue do not apply to the extent that validation, [or] issue [results] *or reissue would result in overissue;* but

(a) if an identical security which does not constitute an overissue is *reasonably* available for purchase [on the market], the person entitled to issue or validation may compel the issuer to purchase and deliver such a security to him against surrender of the security [which constitutes the overissue and], *if any, which he holds; or*

(b) if a security is not so available for purchase, [the purchaser] *the person entitled to issue or validation* may recover from the issuer the price he *or the last purchaser for value* paid for it *with interest from the date of his demand.*

(2) "Overissue" means the issue in excess of the amount which the issuer has corporate power to issue.

[*Italicized words added, and bracketed words deleted, by 1959 amendment.*]

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12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code) § 8-106; P.L. 1023, § 8 (1959):

§ 8-106. *Applicability*

The validity of a security and the rights and duties of the issuer with respect to registration of transfer are governed by the law (including the conflict of laws rules) of the jurisdiction of organization of the issuer.

12A Purdon's Pa. Stats. Ann. (Uniform Commercial Code) § 8-204; P.L. 3, § 8-204 (1953):

§ 8-204. *Effect of Issuer's Restrictions on Transfer*

A restriction on transfer imposed by the issuer even though otherwise lawful is ineffective unless noted conspicuously on the security.

21 Purdon's Pa. Stats. Ann. § 601, P.L. 425, § 1 (1901):

§ 601. [*RESULTING TRUSTS*] *Validity*

Whenever hereafter a resulting trust shall arise with respect to real property, by reason of the payment of the purchase money by one person, and the taking or making of a legal title in the name of another, if the person advancing the purchase money has the capacity to contract, such resulting trusts shall be void and of none effect as to bona fide judgment or other creditors, or mortgagees of the holder of the legal title, or purchasers from such holder without notice unless either (1) a declaration of trust in writing has been executed and acknowledged by the holder of the legal title, and recorded in the recorder's office of the county where the land is situated, or (2) unless an action of ejectment has been begun, in the proper county, by the person advancing the money, against the holder of the legal title.

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N. Y. Real Prop. L. (L. 1909, Ch. 52) (49 McKinney's N. Y. Consol. L.) § 91:

§ 91. *Certain uses and trusts abolished*

Uses and trusts concerning real property, except as authorized and modified by this article, have been abolished; every estate or interest in real property is deemed a legal right, cognizable as such in the courts, except as otherwise prescribed in this chapter.

N. Y. Real Prop. L. (L. 1909, Ch. 52) (49 McKinney's N. Y. Consol. L.) § 94:

§ 94. *Grant to one where consideration paid by another*

A grant of real property for a valuable consideration, to one person, the consideration being paid by another, is presumed fraudulent as against the creditors, at that time, of the person paying the consideration, and, unless a fraudulent intent is disproved, a trust results in favor of such creditors, to an extent necessary to satisfy their just demands; but the title vests in the grantee, and no use or trust results from the payment to the person paying the consideration, or in his favor, unless the grantee either,

1. Takes the same as an absolute conveyance, in his own name, without the consent or knowledge of the person paying the consideration; or,

2. In violation of some trust, purchases the property so conveyed with money or property belonging to another.